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FAIRNESS IN TAXATION

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FAIRNESS IN TAXATION

TUESDAY, MARCH 3, 2015

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:05 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Orrin G. Hatch (chairman of the committee) presiding.

Present: Senators Grassley, Crapo, Isakson, Toomey, Heller, Scott, Wyden, Cantwell, Cardin, Bennet, Casey, and Warner.

Also present: Republican Staff: Tony Coughlan, Tax Counsel; Jeff Wrase, Chief Economist; and Chris Campbell, Staff Director. Democratic Staff: Joshua Sheinkman, Staff Director; Adam Carasso, Senior Tax and Economic Advisor; Todd Metcalf, Chief Tax Counsel; and Tiffany Smith, Senior Tax Counsel.

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order. I want to welcome everyone to today's hearing to discuss fairness in taxation. Senator Wyden has asked me to go ahead.

I also want to thank our witnesses for appearing before the committee today. I am especially delighted that one of our witnesses, Deroy Murdock, is a former intern of mine from the Reagan era. He has gone on to great success, and we are very proud of him. So welcome back, Mr. Murdock. Welcome to our entire panel.

Speaking of the Reagan era, we all know that the last successful comprehensive tax reform effort took place during that time nearly 3 decades ago. During that effort, President Reagan emphasized three principles for tax reform: efficiency, fairness, and simplicity. I have made no secret that I believe these same principles, along with a handful of others, should guide our current reform efforts. The Finance Committee had a hearing on efficiency and growth just last week, and a hearing on simplicity will be coming in the future.

Today we focus on the tax reform goal of fairness. If our tax reform efforts are going to be successful, it is essential that the final, hopefully bipartisan, product is viewed as fair. If the American people do not believe a tax reform proposal is fair, it is hard to see, politically, how it could be enacted.

Quite simply, fairness in the context of the tax code means that similarly situated taxpayers should be treated similarly. The tax code should not pick winners and losers. It should instead be craft-

ed to allow people to prosper with as little interference from the government as possible.

Since the 1986 reforms, our tax code has become riddled with credits, deductions, exclusions, and exemptions, many of which serve to benefit certain taxpayers at the expense of others. A fairer tax code would be one that eliminates many of these tax expenditures, allowing us to broaden the base and lower the overall tax rates. Fairness also means that, to the extent reasonably possible, Americans should make some contributions for the benefits they receive from the government.

Clearly, we need to make exceptions for the truly needy, and indeed our tax code should be progressive enough to acknowledge individual taxpayers' ability to pay. But the current situation, where nearly half the country is effectively shielded from the cost of funding the Federal Government, deserves some attention in any tax reform effort.

There is no denying that some of our fellow citizens, particularly those with lower incomes, have been left behind. Though we have seen some upticks in economic growth, many are not experiencing a positive impact on their own situations. This is a concern to all of us on the committee and to everybody else, I think.

President Kennedy once said that a rising tide lifts all boats. But how is it that we have an economy where not all boats are currently being lifted? Part of the reason for that is that the U.S. law has high hidden marginal tax rates even for low- and modest-income people that discourage career advancement, labor, and savings.

I look forward to hearing more about what we can do to see that more boats are lifted by the rising tide. Fairness will undoubtedly be one of the keys to tax reform.

While I know that, in the context of the tax code, fairness may mean different things to different people, I think we have assembled a panel today that will allow us to sift through these arguments and arrive at some helpful conclusions.*

Before I turn it over to our ranking member, I just want to note that I may have to step out from the hearing, as president pro tempore, to open up the Senate and also for some other duties that I have.

So I thank my friend, Senator Heller, for volunteering to preside in my absence.

In addition, we anticipate the hearing closing out at around 10:20 in order to allow members to attend Prime Minister Netanyahu's address later on this morning.

[The prepared statement of Chairman Hatch appears in the appendix.]

The CHAIRMAN. With that, let me now turn to our ranking member, Senator Wyden, for his opening remarks.

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*For more information, *see also,* "Fairness and Tax Policy," Joint Committee on Taxation staff report, February 27, 2015 (JCX–48–15), *https://www.jct.gov/publications.html?func=startdown&id=4737*.

OPENING STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you very much, Mr. Chairman.

Chairman Hatch, I think you are absolutely right in spotlighting this question of tax fairness. It is absolutely key to the kind of work we anticipate doing in a bipartisan way to work on tax reform. So I very much appreciate your choosing this topic.

Now, if there is a common economic theme to take away from the town hall meetings and other community discussions I have had at home in Oregon, it is that too many Americans feel stuck. Too many Americans worry about being able to afford necessities, like child care and college tuition. Too many Americans say they are struggling to make ends meet and they are simply unable to save.

The fact is, Americans fear more than a daunting climb up America's economic ladder of opportunity. Our people often fear losing hold of the rungs and sliding back into hardship, and the numbers show why.

Mr. Rattner, I know, has discussed this at considerable length. For 15 years, America's middle class has been shrinking, and shrinking for the wrong reason. The fact is, too many of our people have fallen out of the middle class and have not moved up.

Now, no single piece of legislation is capable of turning this all around, but I share the view—Chairman Hatch touched on it in his opening statement—that tax reform can help. As deeply flawed as the tax code may be, it reflects many of our country's most significant economic goals.

There are policies designed to spark innovation and investment and help create high-skill, high-wage jobs. There are policies that fund our safety net, health care, and Social Security programs. Most importantly, there are policies that help hardworking people grab the rungs and climb America's economic ladder.

So the challenge of tax reform can go one of two ways. The first option is to forget those important goals that I laid out and to say that lowering rates is simply your overriding objective. But that would leave too many of our middle class hanging without the means to achieve the American dream of owning a home, saving for a secure retirement, and helping their kids achieve a better future.

The better option is to fix the tax code in a bipartisan way and accomplish our goals more effectively, to build a stronger economy and help more Americans climb the economic ladder. That is the option I prefer. It is the smartest route to a smarter and more efficient tax system, and an unfair tax reform plan would risk heaping a new burden on those who are already struggling to get ahead.

Now, recently there has been considerable discussion that not enough people are pitching in and paying taxes. It focuses on Americans of modest means who are not hit by the income tax. And as we begin this discussion, I just want to unpack this for a moment.

I strongly favor personal responsibility. And I also want us to think, for example, about a young veteran just coming home from serving our country overseas. For the sake of our tax reform discussion, let us just operate under the theory that this veteran has health problems.

As soon as that vet gets home, the bills start piling up. He or she is fighting against a current that has forced a lot of vets into extreme hardship. Some of them have even wound up sleeping in the woods in my home State of Oregon.

But that vet is doing his or her best to grab the rungs and climb the economic ladder, and he or she certainly chips in by paying excise taxes and, when the veteran finds a job, at a minimum, his or her payroll taxes. That veteran is doing his or her part.

One of the tenets of the income tax has always been that it is paid by those who can afford it. So to build fairness into tax reform, let us look back at how the tax overhaul worked. The day President Reagan signed the 1986 Tax Reform Act into law was a landmark day for tax fairness.

President Reagan celebrated the fact that reforms spared 6 million Americans from having to pay income taxes. The President, President Reagan, called it, and I quote here, "the best jobs creation bill, the best anti-poverty legislation, and the best pro-family legislation the U.S. Congress has ever produced." Those are the words of the late President Reagan.

Now, to meet the standard of fairness President Reagan set, I think we also ought to hone in on several other important provisions of the 1986 act. First, it gave fair treatment to wage earners. Instead of punishing them by taxing their income at higher rates than others, it said that income from wages and income from investment would be treated equally.

We have four very distinguished panel members. I can tell you that the architects of the 1986 reform bill were here sitting in your seats, at least two of them, very recently, and they said it could and should be done again.

Second, the 1986 bill cracked down on tax cheats who pry open loopholes and skirt their responsibilities. So today, in connection with this important hearing, I am releasing a report that sheds light on some of the most egregious tax loopholes. They are called "wash sales" or "options collars," and basically they just disguise income. They shield gains.

Sophisticated taxpayers can go out and hire lawyers and accountants to take advantage of these dodges. But when you hear about these loopholes, I am sure that the working-class person just gets more frustrated about what is going on here in Washington and wants reform.

For people having a hard time or just making their way as best they can, too many of our citizens feel that the game is just stacked against them and the other person gets to climb the economic ladder far easier than they do.

The 1986 Tax Reform Act went a long way to changing that, and the Senate version of that bill passed with 97 votes. That is a bipartisan route that Congress ought to take again: a tax reform plan built on fundamental fairness that makes it easier for everybody. And I want to emphasize that word, because you are going to hear me say it a lot. I want everybody in America to be able to climb our economic ladder of opportunity.

I look forward to our four distinguished witnesses. Thank you, Chairman Hatch, for this hearing, and I look forward to tackling this in a bipartisan way.

The CHAIRMAN. Thank you, Senator.

[The prepared statement of Senator Wyden appears in the appendix.]

The CHAIRMAN. Our first witness is Dr. Lawrence Lindsey. Dr. Lindsey was Director of the National Economic Council from 2001 to 2002 and Assistant to the President on Economic Policy for President George W. Bush. He played a major role in formulating President Bush's $1.35-trillion tax cut plan.

Dr. Lindsey graduated magma cum laude with his bachelor's degree from Bowdoin College and with his master's and Ph.D. in economics from Harvard University.

He has authored several books on taxes and is a frequent contributor to the *Wall Street Journal*, *The Weekly Standard*, and other publications.

Dr. Lindsey is chief executive officer of the Lindsey Group, which he runs with a former colleague from the National Economic Council.

Our next witness is Deroy Murdock. Mr. Murdock is a Fox News contributor, a contributing editor with *National Review Online,* and a senior fellow with the Atlas Network, which supports and connects some 462 free market think tanks in the U.S.A. and 93 countries overseas.

Deroy's columns run in the *New York Post*, the *Boston Herald*, the *Washington Times*, *National Review*, the *Orange County Register*, and many other news publications. He has appeared on ABC's "Nightline," NBC Nightly News, CNN, MSNBC, PBS, and other television news channels and numerous radio outlets.

Deroy received his bachelor's degree in government from Georgetown University and his MBA in marketing and international business from New York University.

He was also an intern for me 30 years ago. So I take credit for your success. [Laughter.] We are very proud of you, Deroy.

Our third witness is Dr. Heather Boushey. Dr. Boushey is a senior fellow at the Center for American Progress and the executive director and chief economist at the Washington Center for Equitable Growth.

Her research focuses on economic inequality and public policy, specifically employment, social policy, and family economic wellbeing. She also worked as an economist for the Joint Economic Committee, the Center for Economic and Policy Research, and the Economic Policy Institute.

Dr. Boushey received her bachelor's degree from Hampshire College and her Ph.D. in economics from the New School for Social Research.

Our final witness is Steven Rattner. Mr. Rattner served as counselor to the Secretary of the Treasury and led the Obama administration's successful effort to restructure the automobile industry.

He was an economic correspondent for the *New York Times* before beginning his career in investment banking in 1982 with Lehman Brothers. He later joined Morgan Stanley and then Lazard Frères before forming Quadrangle in 2000, where he was managing principal.

Today, Steven is chairman of Willett Advisors, LLC. That is the investment arm for former New York Mayor Michael Bloomberg's

personal and philanthropic assets, and there are a lot of those. And he is a great friend of mine, so I am happy to see you helping him.

He has also served as a board member or trustee for a number of public and philanthropic organizations.

Mr. Rattner graduated with honors in economics from Brown University in 1974 and is married to Maureen White, a former official of the State Department.

I want to thank each of you for being here and apologize that I have some other duties that conflict with chairing this hearing. But I am going to pay attention to what you say, and I will read your statements. I have read some of them already.

I just appreciate all four of you being here today.

We will start with you, Dr. Lindsey.

STATEMENT OF LAWRENCE B. LINDSEY, Ph.D., PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE LINDSEY GROUP, FAIRFAX, VA

Dr. LINDSEY. Thank you, Mr. Chairman. Senator Wyden, it is good to see you again.

I listened very carefully to your opening remarks, Senator, and I thought you, by quoting John Kennedy, really hit the nail on the head. You mentioned the rising tide lifting all boats. You can concentrate on rising one boat over another boat, but the thrust of my comments today would be, the most important thing to do is have the tide come in, and that is what we are missing.

I am going to not read my testimony, in the interest of time. I would ask that it be submitted in full for the record.

The CHAIRMAN. Without objection.

Dr. LINDSEY. Thank you. One of the problems we are having now is that fundamental economic growth, which is best measured, I think, by labor productivity for long-term growth, just is not happening. The last 5 years, we have had economic growth averaging just seven-tenths of a percent in terms of labor productivity. That is a third of the pace that it has been over the last 3 decades.

I think that is one of the reasons that the people you were talking about, Senator Wyden, are in trouble. I think that they are correct to be angry at what is happening.

The first observation I would make is that getting the tide to come in is the most important thing this committee could do in the form of tax reform, that restoring economic growth is sort of the key.

I give a story in my testimony about comparing the quality of life George Washington had, who was not just a top 1 percenter, but probably a top 1 percent of the 1 percents in his day, with the average quality of life of a Fairfax County resident today, and I think that that comparison points out the advantages of long-term economic growth over simply where you stand in the income distribution. So I think, as far as effectiveness, that is the most important thing to do.

The second observation I would make is that, although I got my start in taxes—I have done a lot of nefarious things in my life, but my original thesis was on tax policy, and here, obviously, there is certainly a bias of having tax policy be able to accomplish things.

The fact is, we are not very good at it. We are not very good at achieving the ends we want to achieve. I would refer you to the first chart that is attached to my testimony, where I am using Commerce Department data on income distribution. And the first observation I would make is that under every President since Nixon we have had, by the three measures given, rising income inequality.

There is almost no relationship—it happened under every President. One of the ironic things, and I think they are ironies—I do not think they are causal—is that, for example, President Clinton had the biggest rise in inequality. Inequality rose more under his 8 years than under Reagan's 8 years and Bush's 8 years combined. And under President Obama's first term, inequality has risen more than it did under George Bush's 8 years.

So again, I am not saying this is causal. I am just suggesting that when we focus on something, it does not mean we are particularly good at achieving the end of reducing inequality, in spite of our ability to talk about it.

Second, if you look at chart 2, you will see that, over this entire period, we have had a big increase in the progressivity of the income tax burden. Here I am comparing taxes paid by various shares with the Commerce Department's definition of income. Effectively, what you are seeing is average tax rates.

I think it is important that we use the Commerce Department's definition as opposed to simple IRS data because, first of all, transfer payments are an important component. They are in the Commerce Department's data. They are not in the IRS data, by and large.

As you will see, the ratio of income paid by the top 5 percent to everyone else has risen substantially, and it has risen consistently since 1980. So, even though we have had an increase in the progressivity of our income tax collections, you still see a rise in inequality.

Finally, to bring home the point that we are not very good at achieving what we want to achieve—and let me say, Senator Wyden, we all agree on the need for reducing income inequality. The chairman was kind enough to mention my efforts in the 2001 bill. In that bill, we took the zero tax threshold from a family of four, a married couple with two kids, from $27,000 to $41,000, which I think was an important positive objective and in line with what you were saying.

But if you look at chart 3, we are comparing the share of income from capital versus the share of income from transfers. So what I am struck by is that, since 1960, the share of income from transfers has tripled from 6 percent to 18 percent, and yet in spite of moving 12 percent of personal income around, we have not been able to reduce inequality.

Well, that suggests that maybe we are not as good as we think we are at achieving our end. So I would go back to the first conclusion. Let us focus on growth. I think growth trumps fairness in its long-term impact, and, second of all, we are not very good at creating fairness, and I would turn it over to growth.

Thank you.

Senator HELLER [presiding]. Dr. Lindsey, thank you. I told Senator Hatch that if this seat is comfortable, he is going to have a tough time prying me out of it. [Laughter.]

[The prepared statement of Dr. Lindsey appears in the appendix.]

Senator HELLER. I certainly appreciate all the witnesses being here.

Mr. Murdock, please continue.

STATEMENT OF DEROY MURDOCK, JOURNALIST, FOX NEWS CONTRIBUTOR, AND SENIOR FELLOW, ATLAS NETWORK, NEW YORK, NY

Mr. MURDOCK. Good morning. Thank you very much for inviting me here.

As we look at today's topic, it would help to start with a thought experiment. I invite everyone in the room to imagine that you are weighing two job offers. Company A offers $50,000, but the boss makes $55,000. That represents an income gap of just 10 percent. I think even Occupy Wall Street could live with that. Now, Company B offers $500,000, but the boss makes $1 million. Imagine that. Income inequality of 100 percent. Who does the boss think he is?

Now, how many of you would prefer job offer A? And how many would prefer job offer B? Exactly. Most people would grab the half a million dollars and laugh all the way to the bank, never mind the 100-percent income gap. And that is the point.

Too much of our political rhetoric these days revolves around envy, resentment, and sometimes even violence toward the affluent, all in an effort to take what they have and redistribute it to those who have less.

Obama's words from September 2011 illustrate this point. He said, and I quote, "If asking a millionaire to pay the same tax rate as a plumber makes me a class warrior, a warrior for the working class, I will accept that. I will wear that charge as a badge of honor."

The American left has made plenty of hay about the notion that the wealthy do not pay their fair share of taxes. This is an exciting slogan. Too bad it is not supported by the facts.

According to the latest Internal Revenue Service data, in 2012, the top 1 percent of tax filers earned approximately 22 percent of all adjusted gross income. They also paid 38 percent of all Federal income taxes. That looks to me like more than their fair share. The top 10 percent of earners made 48 percent of AGI and paid 70 percent of income taxes.

Now, what about the bottom 50 percent? They made 11 percent of AGI and paid just 3 percent of Federal income taxes. So rather than berate top income earners, we should thank them for paying more than their fair share to keep Washington so generously funded.

Rather than obsess over how to squeeze, humiliate, and punish the wealthy, let us focus on how to lift the incomes of those at the opposite end of the income distribution. Rather than drag the wealthy from their penthouses, let us figure out how to bring those

on the sidewalk up to the third or fourth floor and then help them move up from there.

I would make three suggestions. First, America needs a tax code that is geared toward dynamic, robust economic growth—the kind of expansion in national output that enriches the poor and middle class, as well as the affluent.

I recommend scrapping the U.S. tax code, in its 72,000-page splendor, and replacing it with a flat tax. While this idea needs deeper study and proper scoring, the National Taxpayers Union has estimated, very roughly, that a 10-percent tax with no deductions paid by all American adults, would generate about as much income as today's convoluted system.

I call this the 0–10–100 plan, and we can discuss it further, if you like. The fairest tax would be one universal rate. Everyone would pay his fair share.

Two, America's 35-percent corporate tax is the OECD's highest. This is absurd, self-destructive, and a national disgrace. The corporate tax should be slashed dramatically, if not scrapped all together.

Shrinking or eliminating the corporate tax would be a small price to pay for the far, far greater benefit of seeing American companies remain here rather than move offshore and haul jobs with them. And if a far more competitive corporate tax system actually attracts foreign firms to relocate here, all the better for Americans, especially those with low incomes.

Number three, disadvantaged Americans need to make themselves globally competitive. Good luck doing so with the often calamitous government schools that hermetically seal the minds of too many low-income and minority children.

Higher standards, charter schools, and initiatives like the Washington, DC voucher program and New York's private sector Harlem Educational Activities Fund would help these children develop the intellects and skills that they need to prosper in a world where the Internet ships talent across borders at the speed of light.

Thank you very much, Mr. Chairman, Ranking Member Wyden, and the other members of the committee. I look forward to your questions and comments.

Senator HELLER. Mr. Murdock, thank you.

[The prepared statement of Mr. Murdock appears in the appendix.]

Senator HELLER. Dr. Boushey?

STATEMENT OF HEATHER BOUSHEY, Ph.D., EXECUTIVE DIRECTOR AND CHIEF ECONOMIST, WASHINGTON CENTER FOR EQUITABLE GROWTH, WASHINGTON, DC

Dr. BOUSHEY. Thank you. Thank you for inviting me here to speak today. My name is Heather Boushey. I am the executive director and chief economist at the Washington Center for Equitable Growth. The Center is a new project devoted to understanding what grows our economy, with a particular emphasis on understanding whether and how rising levels of economic inequality affect economic growth and stability. I am honored to be here today to discuss a very important topic, the relationship between fairness and taxation.

There are three conclusions from my testimony. First, as inequalities increase, the tax code has not kept pace with this change.

Second, economic evidence shows that inequality is not in tension with economic growth. A variety of research shows that steps taken to reduce inequality do not significantly hinder growth. In fact, low tax rates at the top promote what economists call rent-seeking behavior over productivity-enhancing activities.

Third, there are policy options that can make the tax code more progressive that would have broad benefits for everyone.

The story of the past 4 decades when it comes to inequality is a rapid rise in incomes and wealth for those at the very top. From 1979 to 2012, the average pre-tax income of the top 1 percent grew by 178 percent. At the same time, inequality of wealth has been rising. The share of wealth going to the top .1 percent of households has increased to 22 percent in 2012 from roughly 7 percent in 1979.

What we are seeing is income inequality calcifying into wealth inequality. At the same time, the top marginal tax rate has been dropped considerably, but the improved economic performance that we might have expected given the conventional wisdom simply has not shown up.

A look at the data shows no discernible relationship between the level of the top marginal tax rate and employment or productivity growth since the end of the second World War. When it comes specifically to top tax rates, new research has shown that the optimal tax rate for high incomes in the United States is much higher than previously thought.

When economists break down the link between top incomes and top tax rates, we see that the rent-seeking effects outweigh the supply-side effects. These economists conclude that the optimal tax rate for top incomes could be as high as 80 percent. We know this thanks to new data made available by the IRS, and we hope that that kind of work will continue.

New research also challenges the idea that capital taxation will invariably result in lower savings and, consequently, lower economic growth. Recent work shows that the long-held belief that capital income should not be taxed at all appears to be flawed. The assumptions underlying this research are unrealistic, and recent work has shown that they do not necessarily lead to the often-cited conclusion that capital should not be taxed.

One form of capital taxation is increased taxation of bequests and inheritances. Recent research has found that the optimal taxation level for inheritances is much higher than our current levels, upwards of 60 percent. If we are concerned about the possibility of families passing along large estates to children and the damages that this could have to the vitality of our economy, our current level of taxation is inefficient and there is room there to maneuver.

This knowledge provides a variety of options for you as you are making your decisions on tax policy moving forward. I would just like to offer a couple here this morning.

First, I think there is room to focus on the top by implementing policies like eliminating the so-called stepped-up basis for taxation of bequests. Capital gains on an asset can go untaxed if the asset is bequeathed before the gains are realized. This loophole leaves

quite a bit of money untaxed and disproportionately benefits those at the very top of the income distribution and the wealthy. It can be closed without worries about economic growth.

At the other end of the income spectrum, we can focus on tax policies that boost incomes for those at the bottom; for example, expanding the Child Tax Credit and making it permanent. This credit is partially refundable for a set percentage of income over a set threshold, currently $3,000. The current value and threshold are temporary, and I recommend making these reforms permanent.

The past 4 decades have been a period of high and rising inequality in the United States. Tax policy has an important role to play in the policy response to this major shift in our economy. Our economy currently is not creating prosperity that is broadly shared, and it has not for quite a while.

Today's hearing is an important contribution to this conversation about how to get our economy on track to creating shared prosperity for all Americans, and I thank you for holding it.

Senator HELLER. Dr. Boushey, thank you. Thank you for being here.

[The prepared statement of Dr. Boushey appears in the appendix.]

Senator HELLER. Mr. Rattner?

STATEMENT OF STEVEN RATTNER, CHAIRMAN, WILLETT ADVISORS LLC, NEW YORK, NY

Mr. RATTNER. Thank you very much, Senator. Thank you to Chairman Hatch and Ranking Member Wyden for inviting me here today.

As both Chairman Hatch and Ranking Member Wyden and many others mentioned in their opening remarks, this is the 30th anniversary of the passage of the last major piece of tax reform legislation, and, in my view, it has been far too long since we undertook such an effort. Ensuring a fair and effective tax code is a bit like maintaining a garden. Without constant watering and weeding, it will quickly deteriorate as lawyers and accountants find new ways to ease their clients' tax burdens.

Consider, for example, the wealthiest Americans. In 1995, the 400 highest-income Americans paid just under 30 percent of their adjusted gross income in taxes. By 2012, the tax rate for this group had dropped to 17 percent, in part because of lowered rates on capital gains and dividends, as well as on ordinary income. Meanwhile, overall tax collections remain at the low end of the historic band of 17 to 19 percent of GDP and are projected to remain there.

To be fair, the 1986 law has hardly been gutted. Many of the most egregious tax avoidance schemes that operated prior to the law's passage remain off limits. But other abusive practices have proliferated.

We learned, for example, during the last presidential campaign that one of the candidates was able to amass an individual retirement account with a balance of between $20.7 million and $101.6 million. That occurred in the context of maximum allowed total contributions during the relevant years on the order of $5,000 in total.

Another well-publicized loophole is the ability of private equity and certain hedge fund operators to have their carried interest proceeds taxed as capital gains. At times, including at present, I have been a substantial beneficiary of these provisions, and, for the life of me, I cannot understand why my tax rate on income from my work was less than half of the tax rate paid by friends in other parts of Wall Street on their work.

Other indefensible provisions allow private-equity provisions to convert ordinary income for management fees into lower-tax capital gains on their investments. While lost revenue may not be huge, the significant attention around them contributes to resentment and a feeling of unfairness on the part of average Americans. By now, many Americans know that Warren Buffett's executive assistant suffers under a higher tax rate than he does.

Now, it is true, as Dr. Lindsey noted, that by some measures the progressivity of the tax code has increased in recent years, particularly because of tax reductions for those at the very bottom. However, Congress should also take into account that pre-tax income inequality, as has been also noted, is currently at record levels. No formula exists to determine appropriate levels of progressivity. No doubt, at some level, confiscatory taxes can discourage work. But in my 32 years on Wall Street, I have experienced top marginal Federal tax rates as high as 50 percent and as low as 28 percent, and I never detected any change in my motivation to work or that of any of my colleagues.

Similarly, the tax rate on long-term capital gains has ranged from 35 percent in the 1970s to as low as 15 percent. A tax rate of at least 28 percent on this type of income would be appropriate. In that regard, as has also been noted, remember that the 1986 law provided that capital gains would be taxed at the same rate as ordinary income, a principle to which we should endeavor to return.

In addition to achieving greater fairness, we need more revenue. While our budget deficit has fallen rapidly, it will soon turn back up, and, in that regard, the cost of special rates for capital gains and dividends is substantial, about $120 billion per year.

Let me turn briefly to corporate tax reform. Few disagree that the business provisions of the tax code, as has also been noted, are riddled with loopholes, drive business out of the United States, and create such diversion outcomes as to make the individual provisions look like a paragon of equity.

Practices such as the rampant use of inversions and earnings stripping, and the even more rampant abuse of transfer pricing, have contributed to a massive decline in the contribution of business tax revenues to overall Federal tax revenues from 23 percent in 1966 to 10.6 percent in 2014.

No shortage of meritorious plans exists for how to think about reforms, such as the exhaustive work of the Simpson-Bowles Commission, as well as proposals like the one made by Senators Wyden and Coats in 2011.

Finally, please note that the President's proposed tax reductions, particularly the expansion of the Earned Income Tax Credit, should also be taken into account on behalf of Americans whose incomes have not been raised by the economic recovery.

Thank you very much.

Senator HELLER. Mr. Rattner, thank you. And I want to thank again all the witnesses who are here today, and I certainly do appreciate your time and effort to be here.

[The prepared statement of Mr. Rattner appears in the appendix.]

Senator HELLER. I think we have just defined with the four witnesses in front of us the differences between what we perceive as fairness, and I think that is probably the first question we ought to talk about a little bit. What is fairness?

I think all of us, for the most part, can agree that our current tax code is too costly, too complex, and something needs to change. It is creating unnecessary challenges for families across America, whether they are Nevadans or others, and especially for small businesses.

So I commend the chairman of this committee for his efforts to examine fundamental tax reform. The question is: fundamental tax reform—how are you going to make it fair? And as co-chair of one of the tax reform working groups, I look forward to working with my colleague, Senator Bennet, and others on the committee so that we can create a tax code that, frankly, is simpler, that is fair, and that will work to grow the American businesses.

So I want to go across the panel, starting with you, Dr. Lindsey. Would you repeat, in your mind, what a fair tax code is?

Dr. LINDSEY. I think a fair tax code is one that—I disagree with my colleague to my left here. I have no problem with modest progressivity, but I think fairness also has to balance the relationship between the state and the individual.

It was interesting that Dr. Boushey used the word “optimal,” which is often associated with revenue maximizing. I remember when I wrote my thesis, the first page of my thesis was about that concept, because Jude Wanniski, who is on the opposite side of the spectrum, similarly said “optimal” was revenue maximizing.

There is no such thing because, as you approach the revenue-maximizing level, the excess burden you are imposing on the private sector rises very dramatically, and the revenue, marginal revenue collected by the state, goes down substantially.

So at the revenue-maximizing rate, what you actually get is an infinite preference for money going to the state over money going to the individual. I do not think anyone thinks that is optimal. I mean, maybe Stalin did. But it is not optimal. It is just not optimal.

What we need to keep in mind is that we are a society where the government works for the individuals and not vice versa. So when you start to take—people have to not only work Monday and Tuesday like I do to pay my income taxes, but they also have to work Wednesday and now Thursday to pay their income taxes. I do not think that is fair.

At the same time, though, I favor progressivity. My recommendation—which, of course, like all economists, is in my book—is that I think we have to move away from income-based taxation because I think defining income is part of the problem.

As they say on Wall Street: cash is a fact; income is an opinion. I think we have to move away from opinions, and we have to move toward cash-based taxation. And I think by accomplishing it with

a two-tier cash flow-based tax paid only by the business, we could get rid of the corporate income tax, the personal income tax, and the payroll tax, and have a fair and more pro-growth tax system.

Thank you.

Senator HELLER. Dr. Lindsey, thank you.

Mr. Murdock?

Mr. MURDOCK. My view on this is that the income tax rate should be very low, and it should be consistent across the board. I favor a 10-percent flat tax. My rough calculations are that if everyone paid in, the amount of revenue generated by a 10-percent flat tax would be approximately what we get now with our very elaborate and confusing system that no one really understands.

I fear that once you start adding additional rates and then working, of course, with deductions and loopholes and so on, you are right back to the situation we have now where the government essentially uses the tax code as a blunt instrument for social engineering.

If you have so many children, you get this kind of a benefit. If you are married, you get this. If you are single, you get the other. If you live in an apartment like I do, there is no mortgage deduction. If I go buy a house, then I get a mortgage deduction.

So, unfortunately, the tax code, I think, is used essentially as a way of getting people to behave in the way government wishes them to rather than as an instrument for raising a modest amount of money, or money at a modest rate, to pay for what is required under the U.S. Constitution.

So, again, I think a 10-percent flat tax across the board paid by all American adults would be the way we should go.

Dr. BOUSHEY. I think that is the right question to ask: what is a fair tax code? I think there are three answers. First, we need to be thinking about what kind of revenue we need to be making the investments that we need to grow our economy and to make sure that we have shared prosperity. So we need a tax system that provides sufficient revenue for our national priorities.

Second, we live in a country that has seen rampant and extremely high economic inequality in terms of incomes and in terms of wealth. This has not happened in other developed countries, and there is evidence that this is related to the way that we have constructed our tax system.

Third, we need to consider very seriously the question of whether or not that inequality is good for our entire economy and our society as a whole and if we think that the tax system and the way that it is structured is actually promoting unproductive activities and rent-seeking, rather than productive activities that are benefitting the competitiveness of our economy. That is a question that we need to focus on in understanding what tax fairness is.

It is not just about who gets what. It is about how we are creating the right incentives to have the most competitive U.S. economy. And I think that, unfortunately, the weight of the empirical, serious economic evidence is that our system right now is not promoting the kind of productive investments that we want to be having.

Mr. RATTNER. Let me say two things. First, I think you have to—as I think Dr. Boushey said, you need to separate the question into

two parts. The first question is, what is an adequate level of revenue for the U.S. Government to be able to function? And, as I said in my opening remarks, we are down to around 17.5 percent at the moment, which is the low end of a historic band of roughly 17 to 19 percent that we have, in the fullness of time.

Given the entitlements burdens that we are facing—which I do not believe there is any political will to significantly reduce as the baby booomers such as myself begin to retire—I think that revenue target is going to inevitably have to move up in order to maintain some fiscal prudence. So we not only need every bit of revenue we are getting now, we need somewhat more revenue than what we are getting now.

So the second question is then, who should pay it? And my personal view is that the basic structure of having a progressive income tax—ideally with fewer brackets and certainly with major changes in loopholes, exemptions, and things like that—that basic structure, I think, has served us well for over 100 years and is one that we should maintain.

As I said in my opening remarks, a scenario in which capital income, as valuable as it is to this economy, is taxed in such a way that you have people like Warren Buffett having a lower tax rate than their secretary, seems to me to be patently unfair.

I can think of no way, nor can he, for that matter, to justify that. So I think that as we move toward a simplified structure, we get rid of a lot of the exemptions and loopholes that I went through in my opening statement—I will not repeat them now—and create, I think, a fairer tax code that way, without major surgery in terms of the basic concept of progressivity and having a limited number of tax brackets along the way.

Senator HELLER. Mr. Rattner, thank you. My time is up.

The ranking member, Senator Wyden.

Senator WYDEN. Thank you very much, Senator Heller.

I noted that in his opening statement, Chairman Hatch quoted Jack Kennedy, and you probably heard in my opening statement I quoted Ronald Reagan. So there have to be improved prospects for tax reform given that.

You all have been an excellent panel.

Let me start this way. I think we all understand that about two-thirds of the American economy is now driven by the consumer, and Census Bureau data tell us that workers' paychecks too often do not keep up with inflation. So the consumer is not in a position to make those purchases of durable goods and create demand and put people to work—the kinds of things that grow a private economy.

So I have made, as a central tenet of tax reform—and Mr. Rattner talked about my work with Senator Coats and Senator Gregg. These are bipartisan proposals, and, as a central premise, we have focused on growing American workers' paychecks, putting more dollars into their pocket.

One approach that we took that has been followed by former Chairman Dave Camp is to significantly increase the standard deduction so as to increase the spending power of the middle-class person.

I want to go right down the row, start with Mr. Rattner, who, by the way, I think made very important points with respect to closing tax loopholes. That is something that the staff today reiterated in a staff report that looked at wash sales and collars and all kinds of other dodges that people have come out with. We put that report out today. So I share your view on that.

Let us go down the row and have each one of you offer your thoughts about how to best grow the paychecks of middle-income people, give them the chance to get ahead. What is going to put more money in their pocket? Let us start with Mr. Rattner and just go down the row.

Mr. RATTNER. First, I would certainly have no problem with a proposal along the lines of what you suggested. I think Dr. Lindsey and others might, because it would increase the progressivity of the tax code.

My own view is that, in an era that we are living in of such extreme levels of income inequality, it is appropriate for the tax code, which has been progressive since its inception, to become even more progressive in order to take account of that.

Some will call that redistribution. We can call it what we want. But I would also acknowledge, before others on the panel say this, I think that giving people a higher standard deduction or, frankly, much of what you are going to do with the tax code, is not going to resolve the fundamental problems that we have which are incredibly real, of declining middle-class wages as adjusted for inflation.

I think to really address that is a much broader project for the entire Congress and for every committee of the Congress in different ways, whether it is education, training, investment, R&D, whatever. But it is a very big problem.

I have no disagreement with your suggestion for how to make a dent in it, but recognize that it is a bigger problem.

Senator WYDEN. There is no question it is a big problem. The question is, what can we do to get started, and this is bipartisan. So when you have Dave Camp, Dan Coats, Judd Gregg, at least we have a shot at getting going.

Dr. Boushey?

Dr. BOUSHEY. I think it is a great question. I think I will start where Mr. Rattner ended. Certainly, if you want to grow middle-class income, there are a lot of things you need to do outside of the tax system. Certainly, we need to focus on full employment. That is front and center, the most important thing.

But I think, as we are thinking about the tax system, there is one set of activities that we can think about to put money directly in the hands of middle-class families, such as increasing the standard deduction or the kinds of policies that have been put on the table in terms of reducing taxes for middle-class families more generally.

But I think we also need to think about the intersection between how we are taxing at the top and how we are promoting economic growth and how that is leading to the creation of jobs and the kinds of investment that we want to see.

So, if it is true that the very low marginal tax rates that they were seeing at the top actually promote rent-seeking behavior, that

is money that is being taken out of the economy and out of the investment that firms are making or out of the wages that middle-class workers are experiencing.

So we have to think about all of these things together. So it is not enough to just isolate what is happening to middle-class families.

I would end by, again, sort of ending where you ended, Mr. Rattner, that as an economist, I think many of the things that we need to do to support middle-class families are actually outside of taxes. We need to do things like making sure that people can keep their jobs, making sure that they have schedules that work, and things like that.

Senator WYDEN. Mr. Murdock?

Mr. MURDOCK. I would say that the proposal on increasing the standard deduction is very helpful for people who have jobs. The problem is, we have people who need jobs. If you do not have a job, the deduction is really not all that attractive to you.

So the real focus should be—rather than adding additional bells and whistles to our bell- and whistle-laden tax code—I think we should focus on the overall question of, how do you get this economy growing, not at about 2 percent to 2.5 percent, where it seems to have been stuck for the last 5 or 6 years, but expanding at the rate that it did when I graduated from college in 1986—4 percent, 5 percent, 6 percent, 7 percent?

When I graduated college, all my friends who wanted to work found jobs. Now, one-third of kids graduating from college are living in their parents' basements wondering when their careers are going to get started. It is an awful situation. I think we need to cut our 35-percent corporate tax rate at least to the OECD average of 25. Again, I would cut it to 10 percent or eliminate it altogether in order to entice people to start companies, bring overseas companies here rather than U.S. companies going to Canada and China. How about Chinese and Canadian and British and French and Italian companies moving into the United States?

I also think that the $2.1 trillion in overseas profits that are trapped overseas—I would call it the Welcome Home Tax—bring that money over maybe at a 5-percent tax rate and put that money to work. That will do far more to increase wages and incomes and job opportunities for people than just changing the income tax deduction.

Senator WYDEN. Before we go to Dr. Lindsey, just so we are clear, on the bells and whistles with respect to the tax code, what you do when you triple the standard deduction is you get people out of itemizing. And we have a 1-page 1040 form, and I think all of you would agree with that, and we also have the lowest corporate rate on offer. So I think your point there is also one for following up.

Let us wrap up with Dr. Lindsey. Fitting—a longtime veteran of the tax reform wars.

Dr. LINDSEY. Yes. Again, I think increasing the standard deductions is a reasonable way to do it. As I mentioned, in 2001, we raised the zero threshold from $27,000 to $41,000. We did it mainly by having a 10-percent bracket and by doubling the child credit. So that is all along the same kind of lines. Been there, done that.

I was interested in how to pay for it, and the comment on rent-seeking behavior. I am going to suggest three places where there is rent-seeking behavior.

First, rent-seeking behavior is attracted by price differentials. So the higher the tax rate, by definition, the more rent-seeking there will be exploiting the tax code.

Second, I think the key way of reducing rent-seeking behavior in the tax code is by simplification, and I went to the extreme of, we have to just forget income-based taxation. That would be my recommendation. But I agree, I am out there on that.

The third observation I would make is, where I think most rent-seeking behavior is now that is holding back our economic growth and is also unfair, has to do with maintaining an artificially low cost of capital for an extended period of time.

This is an issue that goes back to Fisher. When money is free, there will be lots of rent-seeking behavior on how to exploit free money. And the more money you have, the easier it is to exploit free money. And I say this as a former Governor of the Federal Reserve.

I think we have to move quickly away from the rent-seeking behavior that is being encouraged by maintaining a zero or near-zero interest rate for an extended period of time.

Long-term, it can do us no good, and I think that right now it is the main source of rent-seeking behavior in America.

Senator WYDEN. We will put you, Dr. Lindsey, with Dr. Boushey to work on trying to deal with rent-seeking, because we have to get going on this in a bipartisan way.

Dr. LINDSEY. Economists all hate rent-seeking.

Senator WYDEN. I understand. I hear you.

Senator HELLER. Senator Cardin?

Senator CARDIN. Thank you, Mr. Chairman. And let me thank all the witnesses here.

This is an important subject for today's hearing, which is fairness in taxation. And I was listening to your testimonies, and I want to talk about the progressive consumption tax, a bill that I filed in December of last year.

One could define fairness as the impact it has on middle-income families, and I agree with that. So we have designed a progressive consumption tax in which low-income and middle-income families will pay no more, and in many cases less, than they are currently paying, answering many of the concerns that you have raised.

We talk about predictability as a matter of fairness, and the one thing I think we learned in 1986 is, our best intentions are hard to maintain. There have been 10,000 changes to the tax code since 1986.

We talk about competitiveness—and we know that we have high marginal rates—as a matter of fairness for economic growth. The progressive consumption tax gets the corporate rate down to 17 percent, starts the income tax at $100,000 of family taxable income at 15 percent, and graduates for over $.5 million to 28 percent.

We talk about rewarding savings for economic growth in this country, and moving toward a consumption tax rewards savings, which helps us accumulate more for economic growth.

Then, as Chairman Hatch said in the beginning of this hearing, you judge fairness by how you are treated compared to your next-door neighbor in the same economic circumstance. The progressive consumption tax taxes all consumptions—goods and services—including all income on the income tax other than four areas of modifications concerning charitable deductions, interest on mortgage expenses, State and local deductions, and the benefits that employers provide for health and retirement.

So it really does simplify. It really does allow neighbors to know that they are being treated fairly, and it throws in, as a matter of fairness, compliance costs that would be much less than the current compliance costs.

So tell me your view. I do not want to hear that this is so radical a change, how can it get done. One hundred sixty countries around the world have consumption taxes. In fact, we are out there with countries that we do not like to be compared with that have not used a national consumption tax.

So, if we are talking fairness, should we be considering the progressive consumption tax?

Dr. Lindsey, I will let you start, because I doubt I am going to get a friendly reply after I heard your last comment. But I would like to get Mr. Rattner's reply on this.

Dr. LINDSEY. Yes, yes. I think that is one way. Senator, I am attracted by the idea. I think I am going to anticipate my colleagues at the other end of the table, and I am not unsympathetic to what I anticipate is going to be their complaint.

I have looked at the issue of minimizing taxation of capital income, and you do it in a very special way in your bill, which is not quite as egregious as what I think they are going to complain about.

Our problem is that, when we separate out capital-based income from labor-based income or special treatment of savings, we open up the possibility of how you define the income and what——

Senator CARDIN. Of course, there are other countries that have done this. I mean, one of the good things about trying to move to a national consumption tax is that other countries have confronted similar problems. And what we have tried to do is take the very best ways of doing it.

Dr. LINDSEY. I like your bill, Senator.

Senator CARDIN. I think I will stop there. That is a good answer. [Laughter.]

Dr. LINDSEY. I would just urge you to go one step further and stop with the definition of income and move to cash-based taxation instead of income-based taxation.

Senator CARDIN. Are there others who want to comment? I am not going to let any of you off the hook. Mr. Rattner, think about your reply, because I am going to get to you.

Mr. MURDOCK. Senator, unlike Dr. Lindsey, I have not read your proposal, but I think it is an interesting one. I am not averse to the concept of a consumption tax of whatever sort—yours or another.

I do have a concern, though—a couple. One is the problem of, "We can get that wholesale." If you have a consumption tax or a

sales tax, people find some way of skirting around the sales tax at the cash register and try to get goods wholesale or whatever.

Senator CARDIN. Of course, we then use the subtraction method, which has been a very effective way of collecting taxes in other countries. So the efficiency issues have been tested in other countries.

Mr. MURDOCK. I do think there is also a matter of shopkeepers having to deal with additional paperwork. That is a bit of a concern of mine. Not a deal killer, but those are words of caution I would have about any kind of a sales tax.

Senator CARDIN. With the chair's permission, I would like to, if I could, have an extra 30 seconds to get a response.

Senator HELLER. Without objection.

Senator CARDIN. Mr. Rattner?

Mr. RATTNER. I am not that familiar with your bill. I apologize for that. But I have no conceptual problem with a progressive consumption tax. To me, at the end of the day, what you have to measure is, what is the full impact of all the taxes on individuals and, for that matter, on business from a fairness or progressivity point of view?

So if a progressive consumption tax—which, as you say, would encourage investment—as used by many other countries around the world, could be incorporated to achieve some of the revenue goals that I mentioned consistent with maintaining at least the current progressivity of the overall tax code, if not increasing it, then I would have no problem with it.

Senator CARDIN. I will take that as an endorsement.

Dr. Boushey, very quickly.

Dr. BOUSHEY. Yes. I would agree with Mr. Rattner on this one. I am certainly not opposed to a consumption tax. I am not familiar with your legislation, but it sounds very interesting.

It has been remarkable that other countries have managed to implement this kind of policy to great effect and have been able to use that to boost revenue in ways that the United States has not.

So I applaud you for looking into this, because that could be a solution to some of our problems.

Senator CARDIN. Thank you very much.

Thank you, Mr. Chairman.

Senator HELLER. Senator Casey, before you start, I just want to remind everybody on the committee, let us try to stay within our 5 minutes. The chairman did say we had a hard stop at 10:20. I just want to make sure everybody gets a chance to ask questions.

Senator Casey?

Senator CASEY. Mr. Chairman, thank you very much. I want to thank Chairman Hatch and Ranking Member Wyden for having this hearing, and I want to thank our witnesses for being here and bringing your experience and your scholarship to these difficult issues.

We need to do more of this for all of us to get to a resolution or even a consensus on tax reform.

I will start with a chart that is not in the materials, just as a predicate for my first question. I will start with Mr. Rattner.

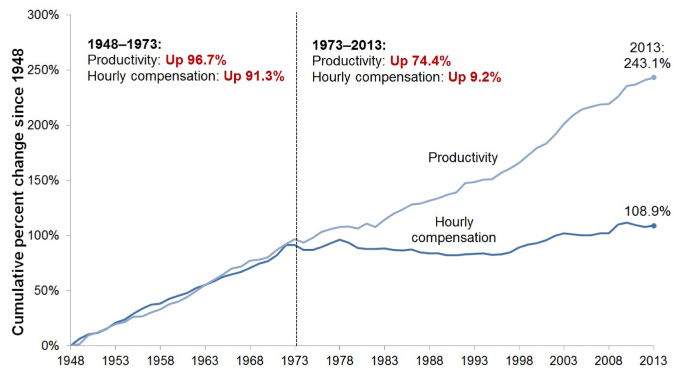
One of the more alarming and maybe, for me, the most alarming charts I have seen in a very long time was set forth in a January

6, 2015 report by the Economic Policy Institute. And, among other things, I will just read—Mr. Chairman, I would ask that this chart be made part of the record.

Senator HELLER. Without objection.

Workers produced much more, but typical workers' pay lagged far behind

Disconnect between productivity and typical worker's compensation, 1948–2013



Note: Data are for compensation (wages and benefits) of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services less depreciation per hour worked.

Source: EPI analysis of unpublished Total Economy Productivity data from Bureau of Labor Statistics (BLS) Labor Productivity and Costs program, wage data from the BLS Current Employment Statistics, BLS Employment Cost Trends, BLS Consumer Price Index, and Bureau of Economic Analysis National Income and Product Accounts

Updated from Figure A in *Raising America's Pay: Why It's Our Central Economic Policy Challenge*

ECONOMIC POLICY INSTITUTE

Senator CASEY. Thank you very much.

I would just read the two time periods. Let me read the headline first. "Workers produced much more, but typical workers' pay lagged far behind." And then the sub-headline is "Disconnect between productivity and typical worker's compensation 1948–2013."

Here is what it says. "1948 to 1973, productivity up 96.7 percent, hourly compensation up 91.3 percent." So almost a perfect alignment between productivity and wages.

Then the second part of the chart is 1973 to 2013, productivity up still again, but only by 74.4; hourly compensation up 9.2 percent—9.2. In the previous period, 91, now up just 9 percent.

So, in addition to the tax issues we are citing today, in addition to the income inequality problem that we cite and also what drives it, I believe the tax code is one of the substantial factors, maybe not the only factor.

So with that as a predicate, I would start with you, Mr. Rattner. On page 4 of your testimony, you say, and I quote, "The 1986 [tax] law provided that capital gains would be taxed at the same rate as ordinary income, a principle to which we should endeavor to return." And then in the next line you give a cost for that of $120 billion per year.

I would ask you, in the context of this committee and ultimately, we hope, the Congress arriving at a consensus on tax reform, how should we evaluate that information that you point to on page 4, meaning the recent trend toward lower taxation of capital gains

relative to ordinary income? How do you think we should evaluate that?

Mr. RATTNER. Well, first, Senator, the chart that you referred to I have seen many times. I feel like it is engraved in my cerebral cortex, because it is really an important chart and a scary chart.

I think the reasons for that mostly lie outside of the tax area, and most relate to globalization and a lot of other factors we could certainly talk about on another occasion.

With respect to the tax on capital income, while I am certainly, as a Wall Street guy, very pro-investment and very sensitive to the need for investment, as I said in my testimony, I have seen the capital gains rate fluctuate to all kinds of different levels during my career.

I have not detected any discernible alignment between the tax rates and investment, work ethic, or anything of the sort, and I think it is a basic element of fairness and the need for revenue in the long run to try to bring the capital gains rate more in line with the income tax rate, which would then also allow the marginal tax rate on work to come down.

So to me, I just think it is a principle that we should all be working toward as part of any kind of comprehensive tax reform.

Senator CASEY. And you base that upon not only your work or your scholarship, but as well on your own experience?

Mr. RATTNER. Well, I am not a scholar, so I base it on my experience. I see a lot of distinguished scholars here. I am sort of out there in the real world, and I see what goes on every day in the financial community, and my clear view is that, especially when it was down to 15 percent and even as it has gradually risen, the tax on capital gains and dividends is far too low.

Senator HELLER. Senator Casey, I have to cut you off. We have to move on.

Senator CASEY. Let me just make one point on the chart, and I will submit a written question to Dr. Boushey.

The reason I cite the EPI chart is not to say the tax problems we are citing today cause it, only to say that, even if we have substantial tax reform, we are not going to get anywhere close to solving this wage problem.

So we have a lot more work to do than just tax reform.

Thank you, Mr. Chairman.

Senator HELLER. Thank you, Senator Casey.

Senator Isakson, if we can reduce to 4 minutes.

Senator ISAKSON. I will not cut anyone off, I promise.

Senator HELLER. Thank you.

Senator ISAKSON. I come from the State of Georgia, which is the home to Neal Boortz and Congressman John Linder, who wrote "The Fair Tax Book" 22 years ago, which was a *New York Times* bestseller, which I think details the ultimate cash-based taxation, Dr. Lindsey, if I am not mistaken. And it proposed a 23-percent sales tax on those with an income above $32,000 and a repeal of the income tax, the payroll tax, and the inheritance tax.

Are you (A), familiar with the book, and (B), do you have any comment on the tax?

Dr. LINDSEY. Yes. It was a very good approach. My only variation on that is, I think it would be easier administratively to move to

a subtraction method, cash-based. Basically, it is a value-added tax; do the sales tax that way.

Secondly, I think if you do that, you can have a two-tier tax that would answer some of the progressivity questions that plague the fair-tax proposal.

Senator ISAKSON. Thank you, and thank you for your work for the country.

Mr. Murdock?

Mr. MURDOCK. I am familiar with the concept. I have not read the book. I believe that, again, one word of caution to all of us is, if people go to the supermarket and confront a 23-percent sales tax, right on top of everything else, I think we have to be careful there is not the temptation to say, "Okay, how can I pay cash? If I give you cash, can I avoid the tax?" and so on. Will that lead to less revenue than intended, therefore, the tax rate has to go to 25 to 27 to 30 percent, and so on and so forth?

So I would offer that word of caution.

Senator ISAKSON. Dr. Boushey?

Dr. BOUSHEY. I am not familiar with the book. While I think it sounds interesting—and I will definitely follow up and look at it—I would caution getting rid of—if I understood you correctly—getting rid of the income tax.

I think that certainly, at least in this country, thinking about the effects of the very high incomes that we are seeing today and the income tax on both economic growth and productivity is something that we cannot discount. But I would be happy to follow up with that.

Senator ISAKSON. Thank you.

Mr. Rattner?

Mr. RATTNER. In the interest of time, I think Dr. Boushey said essentially what I would have said.

Senator ISAKSON. Did you read the book, by chance?

Mr. RATTNER. I have not.

Senator ISAKSON. In fairness to my friends, I will make sure the three of you who did not read it get a copy of the book. I have a box of them at home that I have to get rid of somehow. [Laughter.]

Dr. Lindsey, I agree with your comment on quantitative easing. I think it has masked some of our problems, and one of these days we are going to pay the piper for it.

But there is another thing that contributes to income inequality that I just wanted to mention before my minute runs out. The overregulation of government is causing a lot of stagnation in job growth and I think is a suppressant on raises and income improvement for workers.

Would you agree with that, Dr. Lindsey?

Dr. LINDSEY. Yes. I think complexity is certainly doing that more than increased regulation. It is doing that at least as much as the income tax. We have had an explosion in regulation recently.

Mr. MURDOCK. I agree with you completely. I will just give this observation as someone who lives in Manhattan. The Empire State Building was built in approximately, I believe it was 15 months—start to finish. Try getting a permit to build a parking garage in that amount of time. I think that illustrates the problem of overregulation that you raise.

Senator ISAKSON. Dr. Boushey?

Dr. BOUSHEY. A lot of those regulations are actually local and not Federal, if I understand things. So it seems like a different jurisdiction.

But I would not make the argument that overregulation generally is the big problem. I mean, I would point to studies that show that the United States has lower entrepreneurship than other countries because we do not have the same sorts of social insurance and strong middle class that give people the platform.

That is something that, if we want to sort of look at the regulatory framework that is stymieing entrepreneurship or the platform that is allowing people to become entrepreneurs, it looks like we have really erred on the side of not focusing on giving people that platform.

So, if I were to focus on anything, I would focus there.

Senator ISAKSON. Not to be rude, but to comply, Mr. Rattner, I am going to have to cut you off, because my minute just ended right now.

Senator HELLER. Thank you. Try opening up a gold mine in Nevada. It takes you 7 years to get through the Federal permits.

Senator Warner, and then Senator Scott.

Senator WARNER. Thank you, Mr. Chairman.

Let me echo one of the things my friend, the Senator from Georgia, said. I do think there may be a way—is regulatory relief something we need to look at? I 100-percent agree.

Some of this, though, may be more involved in the timing of giving a decision than just the volume of regulation. So there are ways to think through this, I think, that might give us a new look.

I want to make two comments and then, one quick question, starting with Dr. Lindsey and then coming on down the line.

First, I want to also identify myself with Mr. Rattner's remarks. I love a lot of my colleagues who always go back and say, well, we need to look at the 50-year historic run rate on revenues, which is around 17.4 percent of GDP. What sometimes they forget to say is that we never balance the budget at 17.4.

Based upon the new CBO data, the way they measure this, it is usually between 18.5 percent and 19.5 percent, and clearly we need to bring down spending. And I have taken some arrows for suggestions I have made about entitlement reform.

But without the revenue piece, we are never going to be able to grapple with this. And I would point out—and I appreciate the panel's comments on the consumption tax. I do think it is important to remind ourselves, whenever anyone cites other nations' corporate tax rates, that every one of these other nations that has this enormously lower corporate tax rate has a consumption tax, VAT, however you want to frame it. So we ought to be comparing apples to apples.

I guess the question I have—and I want to start with you, Dr. Lindsey, and I appreciate all the work that we have had to do in the past together, and this is kind of an out-there question.

But traditional economics, in terms of the mismatch between capital and labor, everything we have is about aggregating capital, and everything in our tax code, from capital gains to depreciation

to interest expenses, values capital over labor, because in the past, labor has always been abundant, capital has been scarce.

Is there anything that has happened in the last 30 to 40 years, with overall increase in valuations, with the in-flows of capital, with the diminishment of skilled labor, that has kind of fundamentally changed that equilibrium? Should there be in our tax code some approach that says we should put a little more value on skilled labor versus the tremendous biases we have in the tax code towards capital? Right down the line.

Dr. LINDSEY. It would certainly benefit me if we did that. So I am all for it.

Senator WARNER. Say again, I am sorry.

Dr. LINDSEY. I said it would certainly benefit me if we did that, because I feel overtaxed, especially compared to Mr. Rattner. [Laughter.]

But I would urge pursuing that line of reasoning because of two reasons. One is the excess complexity of defining the difference between labor and capital that now applies because things have gotten so complicated as to what is labor and what is capital.

Secondly, I think one of the reasons for the big changes in the last few years, in particular, has been that artificially low prices of capital imposed by the government greatly increase valuations in that sector, greatly increase rent-seeking behavior in that sector. We will ultimately, as Senator Isakson said, pay a huge price for that.

But I think a lot of the distortions we are now seeing in terms of income distribution and the definition of capital and labor income come from that source and not from the tax code.

Senator WARNER. Quickly, down the line.

Mr. MURDOCK. Rather than that, I would recognize the fact that income tax revenue now is, I believe, a record $1.2 trillion, approximately, according to the Tax Foundation. If we want to bring the budget into balance, what I would do is implement the Penny Plan, in which you spend 100 cents on the dollar this year, next year $0.99 on the dollar, then $0.98. Within about 5 years, the budget comes into balance in, I think, a rather painless way. And you say to people running Federal agencies, “Okay, cut a penny from your budget this year, cut another penny the next.” And if you are any kind of a competent manager, you ought to be able to squeeze one penny out of your budget every year for 5 years and, therefore, balance the budget.

Dr. BOUSHEY. Very briefly. I would direct you to page 7 of my written testimony that references a couple of studies that look at this question, and I can follow up afterwards, in the interest of time.

Senator WARNER. Thank you, Mr. Chairman.

Senator HELLER. Thank you.

Senator Scott?

Senator SCOTT. Thank you, Mr. Chairman.

I just wanted to thank my colleagues for leaving me the balance of the time between now and 10:20 to use at my discretion. Thank you very much for those 20 minutes. [Laughter.] I will try to fill these minutes appropriately. I appreciate that time, sir. I will ignore your 4-minute time that just started.

Dr. Lindsey, I speak at a school in South Carolina every month. I think the future is in those schools. I want to spend time understanding and appreciating what is in their minds and how they view the issue of fairness, and it very often comes up.

One of the questions I typically ask is, if an American or a bunch of Americans earn 22 percent of AGI, but they pay 38 percent of the taxes, is that fair? And I have not found a child so far who thinks that is fair.

Now, I ask a question, if 50 percent of the folks make 11 percent of the income and only pay 3 percent of the taxes, is that fair? I have not found a kid yet who believes that is fair.

Now, certainly, we appreciate the progressive nature of the tax code, but most kids—I speak in many inner-city schools—cannot understand and appreciate that the definition that we use for "fair" does not match anything that they would use for "fair."

So from my perspective, help me understand why those kids are wrong when they believe that, disproportionately, if you make X and you pay twice as much, that is unfair. That makes sense to me.

Dr. LINDSEY. That is because they have not been to Harvard yet. [Laughter.]

Senator SCOTT. Let me make that note really quickly here, sir, because I think you have a point.

Dr. LINDSEY. I think the comments on this definition of fairness are exactly what you are saying. Maybe because I have been around too long I am actually somewhat persuaded by the notion of progressivity, but I think there has to be some limit on that.

As I have noted in chart 2 of my paper, the ratio of the average taxes paid at the top to those paid at the bottom has increased dramatically over the last few years. So I think we are now pushing the limits on that.

Secondly, in spite of that fact, we have a rise in income inequality. So at best, it is ineffective, and at worst, I think it is pernicious.

Senator SCOTT. We were talking earlier about the impact that our tax code and the regulatory burden may have or may not have on creating or stopping entrepreneurs from being creative.

Having been an entrepreneur for the last 20 years, I will tell you that one regulatory burden is not knowing your regulatory burdens. Frankly, as an entrepreneur, when you add them all together, whether it is the State, whether it is the local, whether it is unfunded mandates that come down from the Federal Government, the fact of the matter is that the challenge that we face as entrepreneurs is that we do not have an HR department, we do not have a gang of lawyers waiting to do work for free. We take that role upon ourselves.

You put on top of that the inability to find access to capital because of the increase in the capital gains tax, and you start stifling the innovative nature of entrepreneurs who typically hire people from their own communities, which then has a disproportionate effect on smaller businesses, on minority communities, and those companies that are not yet legacy companies.

Would you like to comment on that, Mr. Murdock?

Mr. MURDOCK. I think you are absolutely right, Senator. I think that you have companies facing local regulations, State regulations, Federal regulations, in many instances, not knowing what the regulations are with Obamacare.

For example, you are starting a company and trying to figure out what your labor costs are, and there are a lot of questions as to what the subsidies will be or not be, how much are you going to make, what will your premium be, et cetera, and there are just a lot of question marks. I never have seen a spreadsheet where there is a question mark on the bottom line that will help you make any sort of a decision.

So I think regulatory relief needs to be part of the equation to advance freedom and prosperity across the board and, as you say, especially in minority communities across the country.

Senator SCOTT. I know my time is up now. Do I have time for another question?

Senator HELLER. It is 10:22. We did have a hard stop because of the Prime Minister's address to the Congress. If you could make it quick, I do not have a problem with it.

Senator SCOTT. Certainly. Mr. Murdock, one thing I noted in your comments had to do with school choice. In my opinion, when we think about the issue of tax fairness and moving forward, if we do not educate those kids who are going to help us solve the problem of entitlement spending, we find ourselves in a very unfair position moving forward, and certainly they do as well.

When I look at the impact in the tax code of not providing preferences to those parents who are already paying for public education but are unable to find a high-performing school in their neighborhood, it seems to me consistently unfair that that person, a single mom like mine, will pay the tax but will not be able to afford to send their student, their child, to a school of their own choosing.

That, to me, seems to be fundamentally unfair, number one, and, number two, seems to lead to great disparity in who can pay taxes and who will pay taxes long-term.

Thoughts?

Mr. MURDOCK. I think you are correct about that. I think one of the things that fuels the inequality on which we focus today is the fact that a lot of people who are stuck, either with poor jobs or no jobs, they are not getting the kind of educations they need in order to get the knowledge and skills and even the contacts that they need in order to prosper in society.

And one of the ways out, and one of the ways to improve this, is school choice to improve inner-city schools so that children actually can get a chance to learn something, to get the skills to be able to graduate out of high school, when the high school graduation rate in a lot of urban centers—the dropout rate, I should say, is around 50 percent. Half the kids are not graduating high school. They never catch up, and they stay behind for life; not just for 4 or 5 years, but for life.

That is a national crisis, and I think, unfortunately, the government school system in the United States, I describe as a system largely of institutionalized child abuse.

Senator HELLER. Senator Scott, I need to move on.

Senator SCOTT. Yes, sir.

Senator HELLER. I want to thank the witnesses who were here today. I want to thank all the Senators who participated. And I have to tell you, I have enjoyed sitting in this seat, as temporary as it may be.

That being said, any questions for the record should be submitted no later than Tuesday, March 10th.

This hearing is adjourned.

[Whereupon, at 10:25 a.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Prepared Statement of Heather Boushey, Ph.D., Executive Director and Chief Economist, Washington Center for Equitable Growth

Taxation and Fairness in an Era of High Inequality

INTRODUCTION

I would like to thank Chairman Hatch, Ranking Member Wyden, and the rest of the Committee for inviting me here today to testify.

My name is Heather Boushey and I am Executive Director and Chief Economist of the Washington Center for Equitable Growth. The center is a new project devoted to understanding what grows our economy, with a particular emphasis on understanding whether and how rising levels of economic inequality affect economic growth and stability.

I'm honored to be here today to discuss a very important topic: the relationship between fairness and taxation. Over the past several decades, economic inequality, on a variety of measures, has increased in the United States. The benefits of economic growth have flowed primarily to households and individuals at the top of the income and wealth ladders. We need to keep this fact in mind when we consider taxation and fairness in the years ahead.

There are three major conclusions from my testimony:

- As inequality has increased, the tax code has not kept pace with this change. The tax code does less to reduce inequality than it did in the late 1970s
- Efforts to reduce inequality are not in tension with economic growth. A variety of research shows that steps taken to reduce inequality do not significantly hinder economic growth
- There are policy options that can make the tax code more progressive that will have broad benefits for everyone

The rest of my testimony will focus on documenting the rise in inequality, reviewing the academic research on the effects of taxation, and some thoughts about where policy should go forward.

THE RISE OF INEQUALITY

Inequality, at least in the popular conversation about it, is talked about like it is a single phenomenon. Even the most widely used measure of inequality, the Gini coefficient, treats it as such. If the coefficient rises, we know that inequality has gone up. But what we don't know is how exactly inequality has increased.

In short, the story of the past four decades when it comes to inequality is a rapid rise in incomes and wealth for those at the top, slower growth for the middle compared to earlier time periods, and stagnation, if not outright declines, for incomes at the bottom of the ladder.

According to data from Paris School of Economics professor Thomas Piketty and University of California-Berkeley economist Emmanuel Saez, the average pre-tax income of the top 1 percent grew by 178 percent from 1979 to 2012. Correspondingly,

the top 1 percent's share of pre-tax income has increased from 8 percent to 19 percent over the same time period.[1]

At the same time, inequality of wealth has been rising as well. According to research by Saez and London School of Economics professor Gabriel Zucman, the share of wealth going to top 0.1 percent of households has increased to 22 percent in 2012 from roughly 7 percent in 1979. That's a 3-times increase in the share of wealth held by the top 10 percent of the top 1 percent. The reason for this rise? The rich have a much higher savings rate than the rest of population and the increase income inequality appears to be calcifying into wealth inequality as the rich save their incomes.[2]

According to data from the Congressional Budget Office, the pre-tax, pre-transfer income of the median U.S. household grew by an average of 0.9 percent a year from 1979 to 2007, the last year before the Great Recession. That growth rate is considerably slower than the 4.7 percent a year for the average income of the top 1 percent of households.[3]

For those at the bottom, the reductions in poverty over the past several decades have been driven almost entirely by tax-and-transfer programs.[4] This means that our anti-poverty programs are working to reduce material hardship. Whether they have reduced it enough is another question. But this research also raises concerns about how the labor market is working for those at the bottom of the ladder.

Another shift toward inequality has been the shift of income from labor income (salaries and wages) toward capital (business income and capital gains). This shift matters for inequality because the distribution of capital income is far more unequal than the distribution of labor income. Households at the bottom and the middle of the income ladder rely much more on labor as a source of income than capital.[5] And capital income is concentrated much more at the top of the income ladder.

As these shifts in inequality occurred, the federal tax system was doing less to reduce inequality, though the federal tax system is still progressive. A quick look at Figure 1 below shows how much the top marginal tax rate for labor income has been declining since the early 1980s.

However as the top rate has decreased, the improved economic performance that we might expect given the conventional wisdom doesn't show up in the data. Figure 2 shows no discernible relationship between employment growth and the level of the top marginal tax rate. If cutting taxes resulted in stronger employment growth then there would be a discernible pattern in the years between 1948 and 2014, represented by a green dot in Figure 2. There is no pattern.

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[1] Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States, 1913–1998," *The Quarterly Journal of Economics* 118, no. 1 (February 2003): 1–39.

[2] Emmanuel Saez and Gabriel Zucman, *Wealth Inequality in the United States since 1913: Evidence from Capitalized Income Tax Data* (National Bureau of Economic Research, 2014), *http://www.nber.org/papers/w20625.*

[3] Congressional Budget Office, *The Distribution of Household Income and Federal Taxes, 2011* (Washington, DC, November 12, 2014), *https://www.cbo.gov/publication/49440.*

[4] Christopher Wimer et al., *Trends in Poverty with an Anchored Supplemental Poverty Measure,* IRP Discussion Paper (Madison, WI: Institute for Research on Poverty, December 2013).

[5] Congressional Budget Office, *Trends in the Distribution of Household Income from 1979–2007* (Washington, DC: Congressional Budget Office, 2011).

Figure 1

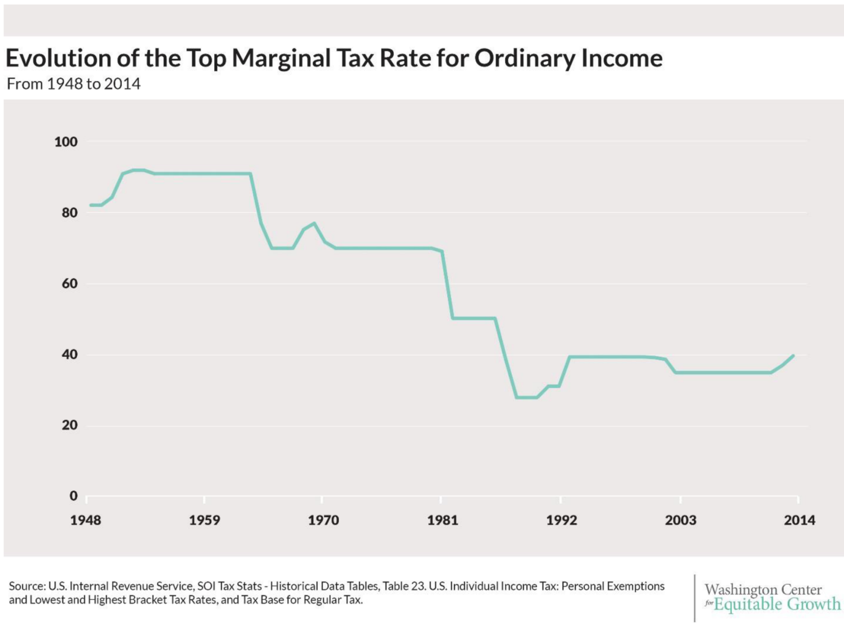
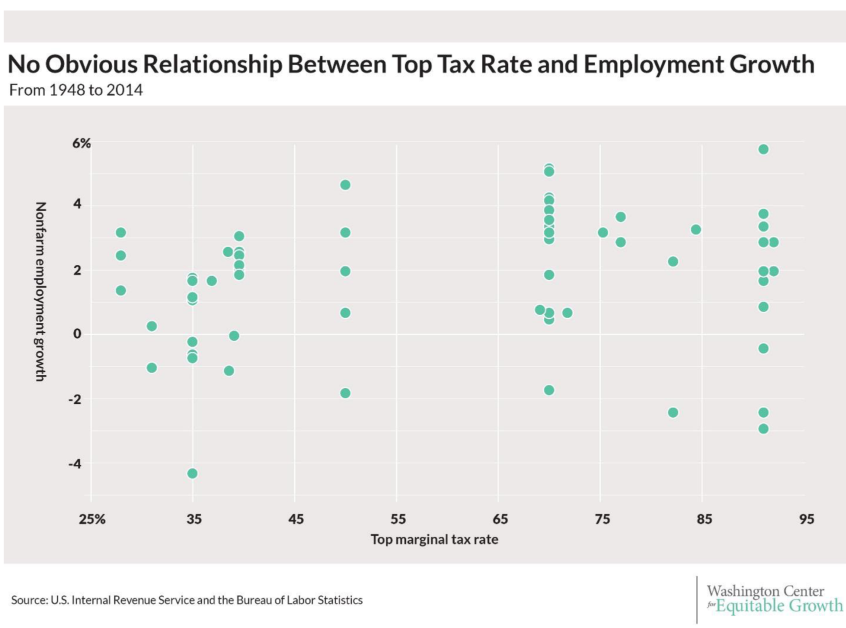


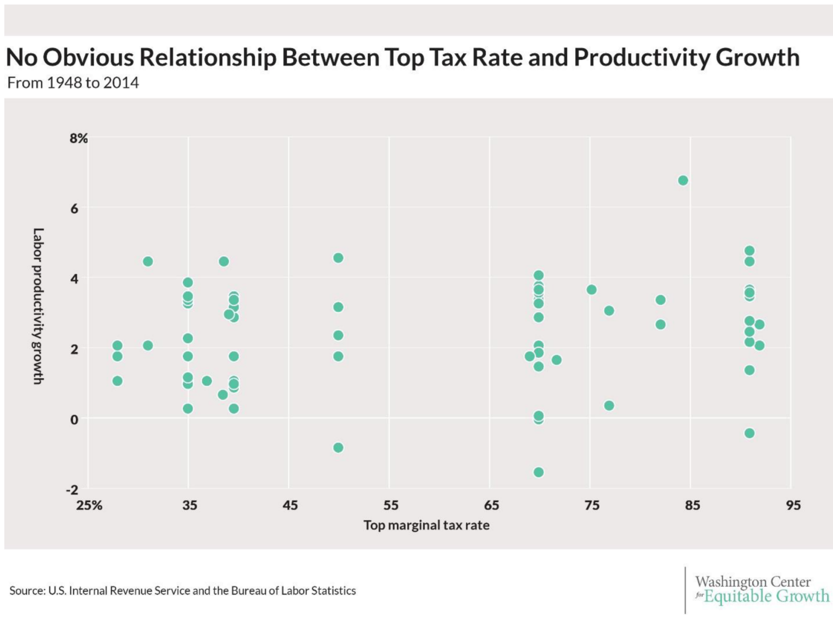
Figure 2



The lack of any obvious relationship isn't the case for just employment growth. Figure 3 below shows that there is no clear correlation between the growth in labor

productivity, one of the key sources of long-run economic growth, and the top marginal tax rate.

Figure 3



A more in-depth treatment of the relationship between tax rates and macroeconomic growth can be found in a 2012 Congressional Research Service report by Thomas Hungerford.[6]

Now it's true that the federal income tax has become slightly more progressive by some measures. But more tax revenue has come from payroll taxes, which have become less progressive. And those at the top of the distribution are paying a large share of federal income taxation. According to Congressional Budget Office data, the top 1 percent of earners had 14.2 percent of federal tax liabilities in 1979. By 2011, that share increased to 24 percent.[7]

Yet over that same time period, the top 1 percent's share of pre-tax income increased from 8.9 percent to 14.6 percent.[8] So if progressivity is measured by the distribution of taxes paid, then progressivity has gone up. But that measure doesn't account for the rising inequality in the distribution of income. The result of inequality increasing as the tax system does less to reduce inequality (as a CBO report points out) is that the inequality of incomes after taxation has increased more than the inequality of income before taxation.[9]

Why should we care about the rise in inequality? There's an emerging consensus in economic research that high levels of inequality can threaten economic growth. My colleague Carter C. Price and I went through the research literature on the relationship between inequality and growth and found that research points toward a negative relationship.[10] As inequality goes up, economic growth tends to go down.

[6] Thomas L. Hungerford, *Taxes and the Economy: An Economic Analysis of the Top Tax Rates Since 1945 (Updated)* (Washington, DC: Congressional Research Service, December 12, 2012), *https://www.fas.org/sgp/crs/misc/R42729.pdf.*
[7] Congressional Budget Office, *The Distribution of Household Income and Federal Taxes, 2011.*
[8] Ibid.
[9] Congressional Budget Office, *Trends in the Distribution of Household Income from 1979–2007.*
[10] Heather Boushey and Carter C. Price, *How Are Economic Inequality and Growth Connected? A Review of Recent Research* (Washington, DC: Washington Center for Equitable

A recent paper by researchers at the International Monetary Fund further finds that redistribution does not necessarily hamper growth.[11] The exact reason for this apparent relationship is unclear and my organization was founded to help better understand it. But the evidence as it stands is cause to seriously grapple with the negative effects of inequality.

ACADEMIC RESEARCH ON TAXATION

Given the rise in inequality, what can tax policy do about this trend? One potential concern about taxation is that in an effort to reduce inequality, it can reduce economic growth and cause more problems than were already there. An increase in labor taxation might cause some workers to work less or an increase in capital taxation might cause a reduction in savings, both of which are important for economic growth.

These assumptions are widely held by policymakers and economics commentators. And to a certain extent they are true. But the level of taxation at which these problems would occur is much higher than usually expected.

On the subject of income taxation, a body of new research shows that labor income taxes for those at the top of the income ladder have no adverse effect on economic growth. A paper by Nobel Laureate Peter Diamond and UC-Berkeley economist Emmanuel Saez reviewed the research literature on income taxation and finds that progressive taxation is well-supported by the research.

When it comes specifically to top rates, another paper by Saez along with Thomas Piketty and Harvard University's Stefanie Stantcheva look at the underlying forces that determine what the optimal level of taxation could be. After accounting for a variety of factors, the three economists find that the top marginal rate could be as high as 83 percent without affecting economic growth.[12] I wouldn't take this paper as evidence that the United States could increase its top income rate to such a level. Rather, the result is instructive that tax rates could be significantly higher without major adverse effects.

Research also shows that reducing certain tax expenditures wouldn't negatively affect the economy either. Research that shows tax incentives are often ineffective at incentivizing behavior. The tax code may provide a tax break for a certain behavior on the belief that this economic incentive will dramatically change behavior, but some work casts doubt on how much behavior is changed by these kind of incentives. Take, for example, Harvard economist Raj Chetty's work on retirement savings decisions. He and his co-authors look at millions of data points on changes in retirement savings after a change in tax policy in Denmark. What they found is that 85 percent of workers were non-responsive to changes in tax incentives and savings rates didn't decline.[13] Of course, this result isn't perfectly applicable to the U.S. situation. But its results are suggestive and should be considered in the U.S. policy situation.

New research also challenges the idea that capital taxation will invariably result in lower savings and consequently lower economic growth. Recent work that shows the long-held belief that capital income shouldn't be taxed at all is flawed. A paper by Piketty and Saez shows the flaws with the famous Chamley-Judd assumptions.[14] Chamley-Judd assumptions imply that savers have infinitely long-time horizons when thinking about saving for the future. If I care about the returns on my savings very, very far in the future, then a tax on savings would end up compounding to a point where the burden is immense. Taxing capital in this situation would drastically reduce savings. But Piketty and Saez show that this assumption doesn't hold

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Growth, October 2014),*http://equitablegrowth.ms.techprogress.org/?post_type=work&p=6900&preview=true.*

[11] Jonathan D. Ostry, Andrew Berg, and Charalambos G. Tsangarides, *Redistribution, Inequality, and Growth,* Discussion Note, IMF Staff Discussion Note (Washington, DC: International Monetary Fund, February 2014),
http://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf.

[12] Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva, "Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities," *American Economic Journal: Economic Policy* 6, no. 1 (February 2014): 230–71, doi:10.1257/pol.6.1.230.

[13] Raj Chetty et al., *Active vs. Passive Decisions and Crowdout in Retirement Savings Accounts: Evidence from Denmark,* Working Paper (National Bureau of Economic Research, November 2012), *http://www.nber.org/papers/w18565.*

[14] Thomas Piketty and Emmanuel Saez, *A Theory of Optimal Capital Taxation,* Working Paper (National Bureau of Economic Research, April 2012),
http://www.nber.org/papers/w17989.

up under scrutiny. And a recent paper by Ludwig Straub and Iván Werning of the Massachusetts Institute of Technology shows that the zero taxation result doesn't even hold up within the Chamley-Judd framework.[15]

There is also the assumption that reducing capital taxation will induce corporations into investing more. The reduction in taxation supposedly will increase the return to investment. But research by the University of California-Berkeley's Danny Yagan finds that the 2003 dividend tax cut didn't have any effect on investment or employee compensation. Yagan compares the investment behavior of public companies, which would were affected by the tax cut, with the behavior of privately held companies. What he found was that the public companies, which should have invested more due to the tax cut, didn't invest more than similar privately held companies.[16]

Another possible form of capital taxation is increased taxation of bequests and inheritances. A 2013 *Econometrica* article by Piketty and Saez argues that the optimal tax rate for inheritances for the United States may be as high as 60 percent. And that the rate would be even higher for those at the very top. In their paper a high inheritance tax is optimal if those bequeathing wealth are relatively unaffected by taxation, inheritances are very unequally distributed and society favors work over inheritance. And the United States fits this description, hence the high level of taxation found in their paper.[17]

With this knowledge, what can we say about tax policy moving forward?

POSSIBLE POLICY STEPS

So we know that inequality has risen in the United States over the past several decades. At the same time we have learned from research that there is more room to make the tax code more progressive to help reduce inequality. There are quite a few policies that could move the tax code in that direction.

There are many examples of changes that would be consistent with the literature. Two that are on the table right now would be eliminating the "stepped-up basis" for taxation of bequests and expanding the Child Tax Credit and making it permanent. A rather large loophole currently exists when it comes to the taxation of capital gains. When a person inherits, say, a large amount of stock holdings from a parent, the inheritor is only taxed on the gains made after they inherit the stocks.[18] So if a parent bought a stock at $1 and it appreciates to $99 before the child receives the stock, then the child would only be taxed on the gains over $99. So the capital gains that occurred over the lifetime on that asset since it was first purchased aren't taxed as income.

If we are concerned about the possibility of families passing along large estates to children and the potential damages that could have on the vitality of the economy, this seems like a loophole we should close. There are a variety of other ideas for taxation in this area, including eliminating the carried interest loophole, whereby hedge fund managers do not pay the ordinary income tax. David Kamin, a professor at New York University School of Law, outlines a menu of options for taxing the wealth of the very wealthy, including transfer taxes, raising the ordinary income tax rates or limiting deductions and exclusions.[19]

But we can also do a variety of things at the low end of the income ladder. One example is the Child Tax Credit, which provides workers with children a tax credit of up to $1,000 per child in hopes of offsetting the costs of raising a child. The tax credit is currently partially refundable for a set percentage of income (15 percent) over a set threshold (currently $3,000). The value of the tax credit has been increased and the threshold decreased, both temporarily, in recent years.[20] I recommend making these reforms permanent. Given the rising costs of child care and

[15] Ludwig Straub and Iván Werning, *Positive Long Run Capital Taxation: Chamley-Judd Revisited,* Working Paper (Cambridge, MA: National Bureau of Economic Research, August 2014), *http://www.nber.org/papers/w20441.*

[16] Danny Yagan, *Capital Tax Reform and the Real Economy: The Effects of the 2003 Dividend Tax Cut,* Working Paper (Berkeley, CA, May 2014), *http://eml.berkeley.edu/~yagan/DividendTax.pdf.*

[17] Thomas Piketty and Emmanuel Saez, "A Theory of Optimal Inheritance Taxation," *Econometrica* 81, no. 5 (2013): 1851–86, doi:10.3982/ECTA10712.

[18] David Kamin, "How to Tax the Rich," *Tax Notes* 146, no. 1 (January 5, 2015): 119–29.

[19] Ibid.

[20] Tax Policy Center, *Taxation and the Family: What Is the Child Tax Credit?* (Washington, DC, n.d.), *http://www.taxpolicycenter.org/briefing-book/key-elements/family/ctc.cfm.*

the incredibly important role of children and the development of their future talents for the future growth of the economy, giving parents more funds to help raise children makes sense.[21]

CONCLUSION

The past four decades have been a period of high and rising inequality in the United States. Tax policy has an important role to play in the policy response to this major shift in our economy. It cannot, and should not, be policymakers' sole response. But changes are needed.

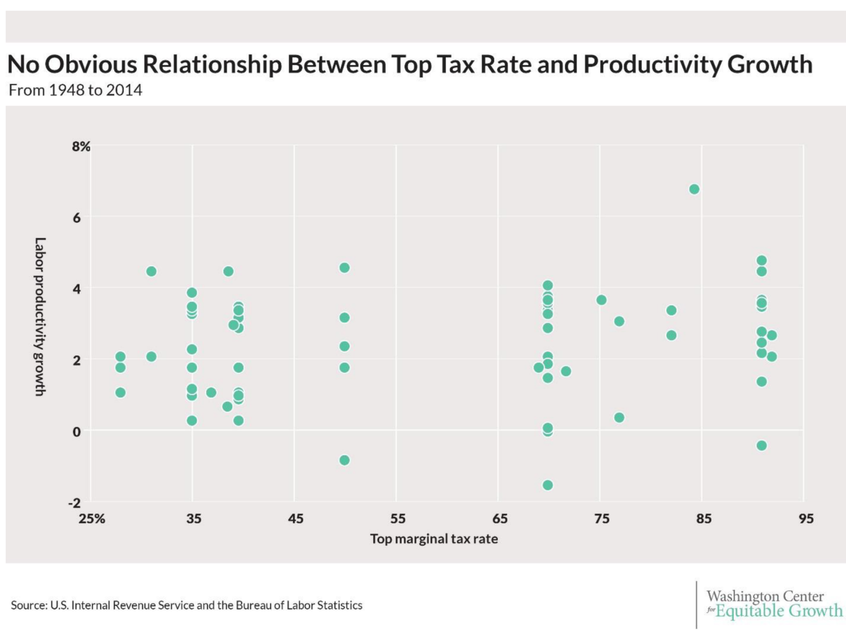
Our economy currently isn't creating prosperity that is broadly shared. And it hasn't for a while. Today's hearing is an important contribution to the conversation about how to get our economy on a track to creating shared prosperity for all Americans.

QUESTIONS SUBMITTED FOR THE RECORD TO HEATHER BOUSHEY, PH.D.

QUESTIONS SUBMITTED BY HON. ORRIN G. HATCH

Question. Dr. Boushey, would you explain your statement that there is no correlation between growth in labor productivity and the top marginal tax rate?

Answer. A 2012 Congressional Research Service report by Thomas Hungerford analyzed the relationship between the 65 year decline in top statutory tax rates and economic growth. He found that top tax rates had little association with savings, investment, and productivity growth. It is often argued that lower tax rates increase investment, innovation, improvement in labor skills, entrepreneurship, and enhanced competition, which are factors in increasing productivity. Thus, it would seem that lowering tax rates would have a positive effect on these factors and would enhance productivity growth. The figure below shows that no positive or negative relationship exists between the top marginal tax rate and productivity growth.



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[21] Heather Boushey and Alexandra Mitukiewicz, *Job Quality Matters: How Our Future Economic Competitiveness Hinges on the Quality of Parents' Jobs* (Washington, DC: Washington Center for Equitable Growth, June 2014),
http://ms.techprogress.org/ms-content/uploads/sites/10/2014/06/062014-parental-jobs.pdf.

Question. In your testimony you state that "as inequality goes up, economic growth tends to go down." Indeed, I think it would be fair to say that that is a theme in your testimony. So, can you please explain that? Dr. Lindsey emphasizes the importance of economic growth and growth in labor productivity. You emphasize that to get growth, we need to address the problem of inequality. So, please explain why rising inequality harms economic growth.

Answer. The most cutting edge studies show that higher inequality is associated with slower income gains among those not at the top of the income and wealth spectrum. The newest research, "Redistribution Inequality, and Growth," by Johnathan Ostry, Andrew Berg, and Charalambos Tsangarides, analyzes inequality across developing and advanced countries and within the United States and finds that, in the long term, inequality is negatively related to economic growth. It also finds that countries with less inequality and a larger middle class have stronger and more stable growth.

Economic theory suggests that this may be because inequality may inhibit the ability of talented, but less fortunate individuals to access opportunities or credit, dampen demand, create instabilities, and undermine incentives to work hard, which may reduce economic growth. As inequality grows, it may also create a relatively larger group of low income individuals who are less able to invest in health, education, and training, which may also slow economic growth.[1]

Question. In your testimony you embrace a study of the retirement system in Denmark that concluded most workers there are not responsive to changes in tax incentives, although you also acknowledge that the result in Denmark may not apply in the U.S. system. The Finance Committee has held hearings on the U.S. retirement system. The evidence we have received in the committee indicates that business owners are motivated to help their employees save, but also are motivated to save for their own retirement. And business owners use the cash flow generated from the tax breaks for sponsoring plans to pay for matching contributions that go to their workers accounts. If the tax incentives are too low, owners won't bother to have a plan at work and workers will lose out. Now, owners can find other ways to save. But it is much harder for low wage workers to find good alternatives to a plan at work. And a plan at work is the best place for average workers to save. *If we reduce the tax incentive in the U.S. as you seem to suggest, what will we do to counter the reduction in coverage for average workers when owners close retirement savings plans?*

Answer. I pointed to the paper, "Active vs. Passive Decisions and Crowd-out in Retirement Savings Accounts: Evidence from Denmark," by Raj Chetty because it questions whether policymakers are indeed having the desired outcome they want. Their research finds that 85 percent of individuals are passive savers and do not respond to tax subsidies. The other 15 percent of individuals in the study are active and respond to tax subsidies by shifting assets.

If owners decide to stop offering retirement plans, there are solutions, consistent with this literature, that will allow workers to continue saving. For example, policymakers may want to look to solutions like the myRA program or the Illinois Secure Choice Savings Program to find how pieces of these programs might be implemented to serve savers across the country.

Question. Common sense tells us that if the lion's share of an additional dollar of income is extracted by the government in taxes, leaving little to the income recipient on an after-tax basis, the incentive to perform whatever activity it is that generates the income is dulled. And this is true up and down the income scale in our existing tax code. At the lower end, for example, some earners can face marginal tax rates above 100 percent, once phase-outs and eligibility rules for various programs are taken into account. To be clear, I don't like high effective marginal tax rates facing anyone, because of the undesirable incentives they put in place. And, I believe that there are federal programs with eligibility rules that are confusing and serve as silos, without any sense that they were designed to account for how the various rules can adversely interact. *My question is whether there is room in tax reform to consolidate, streamline, and simplify the myriad of low- and moderate-income support programs to at least reduce high effective marginal tax rates facing many low-income earners and thereby improve the tax system for those earners?*

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[1] Heather Boushey and Carter C. Price, *How Are Economic Inequality and Growth Connected? A Review of Recent Research* (Washington, DC: Washington Center for Equitable Growth, October 2014), *http://equitablegrowth.ms.techprogress.org/?post_type=work&p=6900&preview=true.*

Answer. Yes, conceivably there is a way to streamline these programs, but, if the concern is high effective marginal tax rates, the concern cannot be wholly addressed using the tax code. Some of these high effective tax rates are driven by means tested spending programs.

Question. In reviewing today's testimony and the dialogue between members and witnesses, you could get the impression that Democrats are solely concerned with vertical equity. Vertical equity is measurement of the tax burdens among income cohorts. Distribution tables are treated as a fetish. Republicans, on the other hand, are delving into the issue of horizontal equity. I find it curious that Finance Committee Democrats weighed in on aspects of horizontal equity in a letter to the Chairman, dated January 29, 2015. The sentence is as follows: "Any reform package must take into account the varying cost of living differences among States and regions, and ensure all middle class families are protected regardless of where they live." *Should we exclusively look at distribution tables?*

Answer. The U.S. tax code could be improved in a variety of ways. We should be concerned about the effects about on the distribution of income and wealth. But at the same time, concerns about horizontal equity are also important. Not only on a geographic basis like in your example, but also based on other characteristics. Two households with the exact same income could have very different tax liabilities because one household owns a home and the other does not.

Question. Dr. Boushey, you assert in your testimony that higher levels of tax on income from capital may not hurt savings and may not hurt economic growth. Should capital gains be taxed at the same rates that ordinary income (including all income from labor) are taxed? Or, should capital gains continue to receive preferential treatment under the Code?

Answer. Given the research I cited about the economic impact of capital taxation, I believe there is evidence that the gap between the two tax rates should be closed. A difference between the tax rates for capital gains and ordinary income can lead to gamesmanship of the tax code. Consider the carried interest tax loophole that allows the income of some managers of large investment firms to be taxed at the preferential capital gains tax rate.

Question. You write in your testimony that there is a 3-times increase in savings by the super-wealthy between the years 1979 and 2012. Is that a bad thing? Isn't higher savings associated with higher economic growth?

Answer. In my testimony, I stated that there is a 3-times increase in the share of wealth held by the top .1 percent. This means that wealth is concentrated in the hands of few.[2] It appears that income inequality is calcifying into wealth inequality as the wealthy have higher savings rates. Such wealth inequality could have important implications for our economy.

Question. Peter R. Orszag, former OMB director and former CBO director, published "To Fight Inequality, Tax Land" at the same time the hearing was scheduled to begin—9 AM, Tuesday, March 3. See *http://www.bloombergview.com/articles/2015-03-03/to-fight-inequality-tax-land.* Do you have any reaction to Dr. Orszag's article? In particular, please share any thoughts you have on this segment from the article: "Joseph Stiglitz . . . argu[es] that Piketty has misdiagnosed the problem of wealth and income inequality, including by ignoring the crucial role of land and housing. And as a result, Piketty's policy proposals may do more harm than good." Please share any thoughts you might have on this paragraph:

> Stiglitz also argues for imposing a land value tax, to directly address this source of increasing wealth inequality. Economists have long favored such a tax, because it does little or nothing to distort incentives: Since land is roughly fixed in supply, there's little one can do to escape a land tax. Indeed, from the perspective of economic efficiency, a land value tax scores higher than even a value-added tax, which is typically seen as the most efficient form of taxation.

Answer. There are a variety of forces that have contributed to the rise of income and wealth inequality over the past several decades, and as Dr. Orzag points out, the increase in the value of land appears to be one such force. I think the topic of land taxation is one worthy of future research and debate in the context of other policies.

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[2] Emmanuel Saez and Gabriel Zucman, *Wealth Inequality in the United States since 1913: Evidence from Capitalized Income Tax Data,* Working Paper, (October 2014), *http://gabriel-zucman.eu/files/SaezZucman2014.pdf.*

Question. Your testimony displays, in Figure 1, the "Evolution of the Top Marginal Tax Rate for Ordinary Income: From 1948 to 2014." You identify that the Figure "shows how much the top marginal tax rate for labor income has been declining since the early 1980s." Were there any variations over that period in the level of taxable income to which those rates apply? If so, could you explain them?

Answer. The beginning of the top income tax bracket has fluctuated over time. For a Head of Household, the dollar amount at which the top rate kicks in has been anywhere from $46,000 to $2.8 million, in 2013 inflation-adjusted dollars, during the period of 1948 to 2012. The level for 2013 was $416,383. These levels have fluctuated over the years as the tax rate has been changes and brackets shifted around. But for the purposes of the graph I presented, these cutoffs are not a major concerns as the tax rate on the very highest earned dollar is the relevant metric.

Question. Your testimony uses the highest bracket "tax rate for regular tax" from Internal Revenue Service Statistics of Income data and, in figures 2 and 3, provides scatter plots of, respectively, employment growth and the top marginal tax rate, and labor productivity growth and the top marginal tax rate. You use lack of correlations to argue, for example, that "[i]f cutting taxes resulted in stronger employment growth then there would be a discernible pattern in the years between 1948 and 2014. . . ." Do you believe that the top marginal tax rate measure that you use is a sufficient statistic to capture any measure of the concept of "cutting taxes" that you identify, and one that could adequately capture the dynamic effects of changes in tax rates on important macroeconomic aggregates? Are you aware of any analyses of changes in tax rates that provide evidence that the changes influenced important macroeconomic aggregates such as employment growth or labor productivity or account for cross-country differentials in labor market aggregates? Are you aware of any analyses of changes in tax rates that provide evidence that lower tax rates contributed to increased equity valuations, benefiting pension holders of all income levels? Do you believe that contemporaneous correlations between tax rates and economic aggregates, or stylized correlations of the type used in the Hungerford paper that you cite which are based on simple regressions with a few time leads or lags, adequately capture long-run dynamic effects of changes on economic aggregates, including quantities and prices?

Answer. The correlations I presented as well as the kind from the Hungerford are, of course, not full blown economic analysis of the question between reductions in top income rates. Rather, these correlations were intended to show that while reduction in taxation might has a positive effect on economic growth depending upon the level of taxation, these kinds of tax cuts are not sufficient for faster economic growth.

Question. You argue in your testimony that progressivity, as measure by the distribution of taxes paid, has gone up. Yet, you also argue that "that measure doesn't account for the rising inequality in the distribution of income." Is it your belief that progressivity, as measured by the distribution of taxes paid, is invariant to the distribution of income and, hence, such a measure does not account for changes in the distribution of the income tax base?

Answer. Federal income tax rates have become less progressive since the 1960s, when economic growth was higher, on average, than it is today and have not responded to the changes in the income distribution. Further, as more revenue has come from the less progressive payroll tax system, the system has become less responsive to rising inequality.

Question. Your testimony identifies "an emerging consensus in economic research that high levels of inequality can threaten economic growth," though the paper by you and Carter Price concludes that inequality and growth research "may be" approaching a new consensus. Your testimony goes on to identify that "research points toward a negative relationship" between inequality and growth, yet "[t]he exact reason for this relationship is unclear. . . ." And you identify in your testimony that "the evidence as it stands is cause to seriously grapple with the negative effects of inequality." Therefore, your argument appears to be that there may be an emerging consensus on a negative relation between inequality and growth, though the reason for such a relationship remains unclear, and therefore we must now implement policies on the basis of a possible relation that we don't understand. Is that accurate? In addition, because there are various policies that could be used to reduce after-tax and after-transfer income or wealth inequality, what leads you to focus on higher death taxes, a $1,000 tax cut for individuals making under $100,000, and expanded child tax credits as the primary anti-inequality tax options for Congress to now consider?

Answer. The weight of the research points away from the belief that economic inequality is good for the economy, and it may be time to re-examine our policies based on this relationship. The paper I wrote with Carter Price lays out the evidence for this.

Because the hearing was focused on taxation, I focused mainly on tax policies that could reduce income and wealth inequality, after taxes and transfers. Eliminating the step up in basis for the taxation of bequests would be a policy intervention to consider if we're concerned about the possibility of families passing on large estates to children and the potential damages that could have on the vitality of the economy. I suggested expanding the child tax credit because of the important role of children and the development of their talents for the future growth of the economy.[3]

Question. Your testimony relies on measures of income and wealth inequality that show significant increases over time. There have been other careful analyses of data on income, by Northwestern University economist Robert Gordon for example, that lead at least some analysts to believe that, as Gordon writes, "[t]he rise in American inequality has been exaggerated both in magnitude and timing." Are you aware of analyses that raise questions about your characterizations of the evolution of the income distribution over the past four decades? If so, why do you disagree with those analyses?

Answer. The magnitude and timing of the increase in income inequality can change based on the data and measurement mechanism used, but inequality remains stark and growing throughout most research.

Question. Some argue that the bulk of inequality in income is attributable to income growth for the upper .1% or even .01% of the income distribution. Do you agree?

Answer. The bulk of inequality is attributed to the ever increasing income and wealth of those at the top of the income distribution. It is compounded by the fact that incomes at the bottom and middle of the distribution are stagnant or barely growing.

Question. Your testimony cites a study that argues that "the top marginal tax rate could be as high as 83 percent without affecting economic growth." You argue that the study may not be evidence that the U.S. could increase its top rate to such a level, but is instructive to identify that "tax rates could be significantly higher without major adverse effects." Please summarize how the study you rely upon treats mobility within the income distribution, dynamics generally, extensive margins, and social welfare weights of differing types of participants in the economy. Based on your identification that the top marginal tax rate could be as high as 83 percent without affecting growth, how high do you think it should be—that is, at what exact value would you recommend that we set the top marginal tax rate?

Answer. The research suggests that top marginal tax rates could be much higher than currently without affecting economic growth.

Question. Your testimony identifies that recent work by Picketty and Saez and by Straub and Warner "shows that the long-held belief that capital income shouldn't be taxed at all is flawed" and discusses "Chamley-Judd assumptions." Whether or not assumptions in two stylized models have "flaws," I think that most would agree that there typically are sensitivities of results of stylized economic models to alterations in assumptions. For example, it has been known for some time now that with incomplete insurance markets and borrowing constraints, there are model structures in which a social-welfare maximizing tax planner would choose non-zero capital income tax rates even in the long run. Of course, even in those models and in the work by Picketty and Saez and by Straub and Warner, there exists sensitivity of results to variations in assumptions. Therefore, from this area of your testimony, I conclude that results of stylized models are sensitive to assumptions. Is this an accurate reading?

Answer. Your reading is accurate. Stylized models, while important to economics, can be quite sensitive to the assumptions built into the model.

[3] Heather Boushey and Alexandra Mitukiewicz, *Job Quality Matters: How Our Future Economic Competitiveness Hinges on the Quality of Parents' Jobs* (Washington, DC: Washington Center for Equitable Growth, June 2014), *http://ms.techprogress.org/ms-content/uploads/sites/10/2014/06/062014-parental-jobs.pdf.*

PREPARED STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH

WASHINGTON—Senate Finance Committee Chairman Orrin Hatch (R–Utah) today delivered the following opening statement at a committee hearing on fairness in taxation:

The committee will come to order.

I want to welcome everyone to today's hearing to discuss Fairness in Taxation. I also want to thank our witnesses for appearing before the committee today. I'm especially delighted that one of our witnesses, Deroy Murdock, is a former intern of mine from the Reagan era.

Welcome back, Mr. Murdock. Welcome to our entire panel.

Speaking of the Reagan era, we all know that the last successful comprehensive tax reform effort took place during that time, nearly three decades ago. During that effort, President Reagan emphasized three principles for tax reform: efficiency, fairness, and simplicity.

I've made no secret that I believe these same principles—along with a handful of others—should guide our current reform efforts.

The Finance Committee had a hearing on efficiency and growth just last week. And a hearing on simplicity will be coming in the future. Today, we focus on the tax reform goal of fairness.

If our tax reform efforts are going to be successful, it is essential that the final—hopefully bipartisan—product is viewed as fair. If the American people do not believe a tax reform proposal is fair, it's hard to see, politically, how it could be enacted.

Quite simply, fairness, in the context of the tax code, means that similarly situated taxpayers should be treated similarly. The tax code should not pick winners and losers. It should, instead, be crafted to allow people to prosper with as little interference from the government as possible.

Since the 1986 reforms, our tax code has become riddled with credits, deductions, exclusions and exemptions, many of which serve to benefit certain taxpayers at the expense of others. A fairer tax code would be one that eliminates many of these tax expenditures, allowing us to broaden the base and lower the overall tax rates.

Fairness also means that, to the extent reasonably possible, Americans should make some contributions for the benefits they receive from the government. Clearly, we need to make exceptions for the truly needy. Indeed, our tax code should be progressive enough to acknowledge individual taxpayers' ability to pay. But, the current situation—where nearly half the country is effectively shielded from the cost of funding the federal government—deserves some attention in tax reform.

There is no denying that some of our fellow citizens—particularly those with lower incomes—have been left behind. Though we've seen some upticks in economic growth, many are not experiencing a positive impact on their own situations.

This is a concern to all of us.

President Kennedy once said that a rising tide lifts all boats. But how is it that we have an economy where not all boats are currently being lifted?

Part of the reason for that is that U.S. law has high hidden marginal tax rates—even for low- and modest-income people—that discourage career advancement, labor, and savings. I look forward to hearing more about what we can do to see that more boats are lifted by the rising tides.

Fairness will undoubtedly be one of the keys to tax reform. While I know that, in the context of the tax code, fairness may mean different things to different people, I think we've assembled a panel today that will allow us to sift through these arguments and arrive at some helpful conclusions.

Before I turn it over to our ranking member, I just want to note that I may have to step out from the hearing. I thank my friend Senator Heller for volunteering to preside in my absence.

In addition, we anticipate the hearing closing out at around 10:20 a.m. in order to allow members to attend Prime Minister Netanyahu's address later on this morning.

With that, I now turn it to Ranking Member Wyden for his opening remarks.

PREPARED STATEMENT OF LAWRENCE B. LINDSEY, PH.D., PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE LINDSEY GROUP

GROWTH, FAIRNESS, AND ECONOMIC WELL-BEING

Chairman Hatch, Senator Wyden, Members of the Committee. It is an honor to be here today to discuss the role taxes play in promoting and broadening economic well-being in our country. It is no secret that many if not most Americans are dissatisfied with our economic performance and they have a right to be. Earnings are stagnating and people are concerned about their future and that of their children.

Ultimately our economic well-being depends on what we are able to produce. Government spending doesn't create prosperity, borrowing doesn't create prosperity, printing money doesn't create prosperity. Taking the income one person produces and giving it to another person doesn't create prosperity, it merely moves it around. As Adam Smith observed 240 years ago, the wealth of a nation is driven by its productive capacity. Society can't consume what it doesn't produce and it can't redistribute what it doesn't produce, so when we consider how policies can create widespread economic well-being that is the place we must start.

The most common measure of our ability to produce is a data series issued by the Commerce Department known as "Productivity in the Non-Farm Business Sector." It shows why we are so unhappy with our economic performance. In the last four years productivity has shown average growth of just 0.7 percent per year. That is the worst four year performance since the Carter Administration. By contrast, average productivity growth over the last three decades had been much higher and had been accelerating, averaging 1.7 percent annually in the 1980s, 2.2 percent annually in the 1990s, and 2.6 percent annually in the first decade of the 21st century. In short, our productivity growth in the last four years has only been about one third what it averaged over the previous thirty years.

In terms of living standards for the typical person in a country, productivity growth completely dominates distributional considerations over a long period of time. Consider a thought experiment I just did with my son who is now taking introductory economics. If productivity grew as slowly as it has in the last four years, output per worker today would be a bit less than 5 times what it was when George Washington was President. By contrast, if output per worker grew as quickly as it did during the previous 30 years, living standards would be almost 80 times what they were when Washington was President. That is a 16-fold difference in living standards, roughly the difference between quality of life in today's America and that of Yemen or Kyrgyzstan.

Indeed, growth wipes out distributional differences. Consider how the typical American lives today compared to George Washington. Most of us have been to Mount Vernon. Nice place. And Washington was not just in the top one percent in his day, he was probably well within the top tenth-of-one-percent. Mount Vernon has seven bedrooms and about 7,000 sq. of living space. It had no bathrooms. No running water. No central heating. No air conditioning. A severely outdated kitchen that could only be accessed by going outside. I dare say that almost any family in the Fairfax County housing market today would opt for a typical home in a subdivision over Mount Vernon circa 1776. Mount Vernon would be listed as a real "fixer upper," and housing is just the start of it. Washington died at 67, more than a decade before a typical male today. He had dentures made of wood—and doubtless suffered from tooth aches regularly. He traveled a lot for a man of his day, but never overseas, and probably put on in his lifetime fewer miles on horseback than a typical person puts on their car in a year. Not a lot of fresh fruits and vegetables in his diet during much of the year. Obviously no electronics. The simple fact is that the typical American today lives far better than George Washington did.

Why is that? Although there has been some reduction in inequality since that time, the reason a typical American lives better than Washington did is productivity growth, not redistribution. Over the history of the Republic growth has probably been quite a bit better than in the last four years, but probably not as good as the previous thirty. Real per capita incomes are probably up by a factor of about 40 implying real productivity growth of about 1.7 percent per year. But as a result, a median family today, or even one well below median, lives far better than someone who was in the top one tenth of one percent when the country was founded.

This is a critical point. An overemphasis on redistribution at the expense of economic growth and economic dynamism and entrepreneurship is severely misplaced if what one really cares about is the well-being of the typical citizen of the country both today and in the future. As our Founding Fathers said when they wrote the Constitution, our purpose is to "secure the blessings of liberty for ourselves and our posterity." It provides a basic lesson in tax design. In the short run an emphasis on fairness is at best a zero sum game. In the long run, policies that promote economic growth are almost invariably the ones that help the typical individual the most.

There is a second reason why an overemphasis on redistribution as the goal of tax policy is a mistake: history suggests that it is not very successful even at achieving the narrow goal for which it is intended. Let us consider the historical record. Although a lot of political rhetoric is expended talking about redistribution, neither political party has been particularly effective at fostering policies that make American income distribution more equal. Chart 1 shows the change in three measures of income inequality used by the Department of Commerce to give a summary statistic of the state of income inequality in America. In all cases a positive number indicates a more unequal distribution of income over that Presidential term. Note that by most measures, income inequality has risen under every President for half a century, most rapidly under President Clinton, increasing more during his eight years than the eight years of President Reagan and the eight years of President Bush combined. And, in President Obama's first term income inequality rose as much or more than it did during both of President Bush's two terms combined. Rising income inequality was not the intent of any of these Presidents; it just has not been something that has proven very tractable to public policy. If anything, the historical record suggests that a political preoccupation with redistribution is associated with a rise in income inequality, not a reduction.

In fact, data from the Census Bureau suggests that inequality has risen quite sharply in the last few years despite an enormous increase in the attention of the political process to the problem. The ratio of the income of a family in the 95th percentile relative to the median has risen to a new historic record in the last six years, from 3.58 to 3.78. The ratio of the income of a family in the 95th percentile relative to a family in the 20th percentile has risen even more, from 8.69 to 9.38, also an historic record. The share of income received by the top 5 percent has risen from 21.5 percent to 22.3 percent over the same time frame. Yet, I cannot remember a period in my life when so much political effort and legislation was devoted to the topic of inequality.

Chart 2 shows how much more progressive income taxation has become since 1980. The first column shows the share of income received by the top 5 percent of the income distribution according to the Department of Commerce. The second column shows the share of income taxes that they pay. Note that both columns have grown. The share of income received by the top 5 percent has risen a little over 5 percentage points in the last 30 years. The share of income taxes paid by the top 5 percent has risen a bit more than 20 percentage points over the same time. The third and fourth columns compare the taxes paid and income received by the top5 percent and by the other 95 percent of households. In 1980, for example, the share of taxes paid by the top 5 percent of the income distribution was roughly 2¼ times their share of the income they received. For the remaining 95 percent, the share of taxes they paid was about ¾ their share of income. Thus, by comparing these ratios we get a sense of how much the average taxes paid by the top 5 percent compares with the share of taxes paid by everyone else. In 1980 the top 5 percent paid about three times what everyone else paid in terms of their share of income. By 2010, the share of taxes relative to the share of income for the top 5 percent had risen to about 2¾ while the same ratio for everyone else had fallen to about ½. This means that by 2010 the relative tax burdens had risen from 3 times to 5¼ times.

The chart is illustrative for two reasons. First, the top marginal tax rate generally declined during that period. It was 70 percent in 1980 and fell to just over 35 percent by 2010. Despite this, the share of taxes paid by the top 5 percent rose consistently, and it also rose consistently faster than their share of income. Second, despite an ever increasing share of income taxes being paid by the top 5 percent, income inequality continued to rise. In other words, higher taxes are simply not an effective means of leveling out the income distribution. I suspect that when the data come out for 2015 the trend will have continued. The average tax rate on higher earners will have risen relative to others as will have their share of income. The policies

of the last few years have been ineffective at best, and possibly counterproductive, at producing a more equal distribution of income.

The other important indicator about the inability of government policy to affect income distribution is that income inequality has risen despite a massive increase in the share of income that government redistributes. Consider the third chart in this presentation. It shows the shares of personal income that come from government transfer payments to individuals and the share of income coming from what the national income accounts call property income—interest and dividends. Despite the indications of rising income inequality over the last half century or so, the share of personal income coming from transfer payments has roughly tripled, from six cents on the dollar to eighteen cents on the dollar. It is almost incomprehensible that one can move a full twelve percent of income around in an effective matter and not make income distribution more equal if that is the intent. The other line on the chart shows the share of income that is property income. That shows a more complicated pattern, rising until 1980 and then falling after 1990. Today transfer payments are a more important source of personal income than are interest and dividends, an enormous change. If anything, the decline in property income relative to transfers makes the failure of redistributionist policies even more compelling. Politically inspired policies may sound good rhetorically on the evening news, and certainly promote a narrative the news media finds compelling, but the success of this rhetoric or the policies they advance is not borne out by the facts.

In conclusion, I would leave this committee with three points. First, rising income inequality probably cannot be successfully addressed through the tax code or through other intentional redistributionist policies. Second, the best way to increase the well-being of the typical citizen is to focus on productivity and economic growth, not on redistribution. Finally, I would strongly urge this Committee to focus on the simplification of taxation. Complex taxation neither promotes economic growth nor redistributional objectives. Those with the greatest resources have the greatest ability to promote complexity and to exploit it once legislation is passed.

Thank you and I would be happy to answer any questions.

Chart 1
Neither Party Has Reduced Income Inequality

Presidency	Change in GINI Coefficient	Change in Mean-Log Coefficient	Change in Theil Coefficient
Nixon/Ford 8 years	+0.012	+0.005	−0.002
Carter 4 years	+0.005	+0.014	+0.003
Reagan 8 years	+0.023	+0.026	+0.040
Bush-41 4 years	+0.007	+0.015	+0.019
Clinton 8 years	+0.029	+0.074	+0.081
Bush-43 8 years	+0.004	+0.051	−0.006
Obama 4 years	+0.011	+0.045	+0.025

Source: U.S. Dept. of Commerce, The Lindsey Group, See Also Lindsey *The Growth Experiment Revisited* (2013) p. 208.

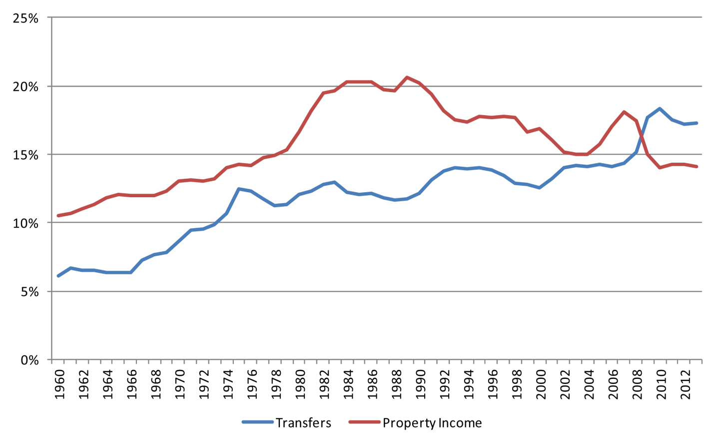
Chart 2
Share of Taxes Paid by Rich Rose Faster Than Their Share of Income

	Top Five Percent		Tax Share/Income Share		Ratio of Tax/Income
	Share of Income	Share of Income Tax	Top 5%	Everyone Else	Shares Top/Bottom
1980	16.5	36.9	2.24	0.76	2.95
1990	18.5	43.6	2.36	0.69	3.42
1995	21.0	48.9	2.33	0.65	3.58
2000	22.1	56.4	2.55	0.56	4.55
2005	22.2	58.9	2.65	0.53	5.00
2010	21.7	59.1	2.72	0.52	5.23

Source: Bureau of Census, Internal Revenue Service.

Chart 3

Transfer Payments Now Bigger Than Capital Income



Source: Bureau of Economic Analysis

QUESTIONS SUBMITTED FOR THE RECORD TO LAWRENCE B. LINDSEY, PH.D.

QUESTIONS SUBMITTED BY HON. ORRIN G. HATCH

Question. Dr. Lindsey, this question is for you. Dr. Boushey says in her testimony that there is no clear correlation between growth in labor productivity and the top marginal tax rate. It frankly surprises me, but she is clearly a very intelligent and informed woman, so I wanted to get your thoughts on that. Do you have a response to that? Do you agree?

Answer. The use of the simple “top marginal rate” in such a calculation is what statisticians would consider a mis-specified variable, meaning in plain English that it doesn’t measure what it purports to measure. For example, in 1960 the top rate was 91 percent, but only 8 taxpayers in the country paid at that rate, so it was kind of meaningless. Very high rates have usually been accompanied with ample ability to avoid those rates and in this period business losses were generally deductible against other income; rental real estate and other forms of business activity were widely used. If the rates and the rules were stable for a long period of time, and they were, the change in productivity would not be affected by the level of rates since other factors, and not the tax rate, were at play. The reduction in the top tax rate from 91 to 70 percent—the so-called Kennedy Tax Cut—was accompanied by an enormous boom in economic growth.

Moreover, broad based rate reductions may have the effect of dramatically increasing the supply of labor thereby temporarily depressing the measured labor force productivity. A prime example of this was the Reagan cuts in the early 1980s which sharply increased the labor force participation rate of middle and upper middle class married women. In 1980 the 49 percent bracket hit a married couple at a taxable income of just $41,500 making participation by a second earner in a middle class household fairly unattractive. Reagan not only cut that rate by 25 percent, he added a ten percent deduction for the earnings of the lower-earning spouse. Female labor force participation, which had been relatively stagnant in the late 1970s surged beginning in 1982. The immediate effect was a slowing in productivity, but ultimately, the addition of these workers led to a productivity and economic surge that lasted for several decades.

Question. Common sense tells us that if the lion's share of an additional dollar of income is extracted by the government in taxes, leaving little to the income recipient on an after-tax basis, the incentive to perform whatever activity it is that generates the income is dulled. And this is true up and down the income scale in our existing tax code. At the lower end, for example, some earners can face marginal tax rates above 100 percent, once phase-outs and eligibility rules for various programs are taken into account. To be clear, I don't like high effective marginal tax rates facing anyone, because of the undesirable incentives they put in place. And, I believe that there are federal programs with eligibility rules that are confusing and serve as silos, without any sense that they were designed to account for how the various rules can adversely interact. My question is whether there is room in tax reform to consolidate, streamline, and simplify the myriad of low- and moderate-income support programs to at least reduce high effective marginal tax rates facing many low-income earners and thereby improve the tax system for those earners?

Answer. Senator, your observation about high rates affecting the economic decisions of everyone is spot on. And it is not just the legislated tax rates that matter—the withdrawal of benefits also acts like a tax. The Congress has recognized this in the case of social security payments and has reduced or eliminated the reduction in benefits paid to older workers—thus helping older workers participate. Last year 45 percent of the net increase in the labor force was by individuals over age 55—an amazing number. The biggest deleterious effect of recent expansions in the availability of benefits has been on married families with children in the $25,000–$50,000 range. Numerous studies, including by center-left think tanks like the Urban Institute and the Hamilton project have noted that work by the second spouse in these households often leads to 50–80 percent marginal tax rates. Labor market data suggests that roughly 2½ million middle aged workers have left the workforce since 2007 and not re-entered as a result. The Congressional Budget Office estimated that more than 2 million fewer workers would be in the workforce just because of Obamacare.

The right way to fix this is, as you note, a simplification of our overly complex and overlapping benefit structure. Much of this is within the jurisdiction of the Committee. The easiest reform is not by adding another tax provision, but by tackling these other programs directly and ideally integrating them into a combined tax/transfer structure.

Question. In reviewing today's testimony and the dialogue between members and witnesses, you could get the impression that Democrats are solely concerned with vertical equity. Vertical equity is measurement of the tax burdens among income cohorts. Distribution tables are treated as a fetish. Republicans, on the other hand, are delving into the issue of horizontal equity. I find it curious that Finance Committee Democrats weighed in on aspects of horizontal equity in a letter to the Chairman, dated January 29, 2015. The sentence is as follows: "Any reform package must take into account the varying cost of living differences among States and regions, and ensure all middle class families are protected regardless of where they live." Should we exclusively look at distribution tables?

Answer. There are numerous statistical problems with distribution tables. For example, transfer payments, which now constitute nearly one dollar in every five of personal income, are excluded from the measure of income as well as from the net distributional effect of our tax/transfer system. Capital gains is counted as "income" in the year the asset is realized. Note first that capital gains is NOT considered as "income" in the National Income Accounts and is not income in most accounting. Note also that since many such gains are realized in a large amount in a single year and are not recurring, they by their very nature exaggerate the tax effect in the income distribution.

But most important, as the tables I present clearly show, the distribution of the tax system has become enormously MORE progressive over the past few decades and DESPITE this there has been very little impact on the measured distribution of income. At best therefore, one could describe the over emphasis on this type of statistical analysis as misplaced.

Question. Dr. Lindsey, you say that "higher taxes are not an effective means of leveling out the income distribution." But why not? It would certainly seem like they would be. That would be my intuition. And if taxes aren't effective, then what is effective at leveling out the income distribution?

Answer. The most important effect of high marginal tax rates is to reduce social mobility—they are like a high entry fee to join a club, in this case, the club of the

well-to-do. If I start as an ordinary American but want to be well-to-do and the government taxes my efforts to earn, save, and accumulate, I have very little prospect of "making it." Enhanced regulation has the same effect, as does limiting choice in education. Big government involvement in our economic lives has the effect of locking in the status quo, not trying to change it.

Question. Dr. Lindsey, you say, and I agree with you, that the Committee should focus on simplification. You also say that the tax code does not advance re-distributionist goals well. Could it be that the tax code's redistributionist goals are stymied by its own complexity? That is, lower-income people aren't helped by many of the re-distributionist provisions in the Code, because they can't understand them, and the upper-income people are able to plan around the re-distributionist goals because they can afford to hire experts to navigate their way through the complexity?

Answer. Senator, your question is right on point. Complexity is the enemy of fairness. Complexity favors those who can hire lawyers and accountants to figure out how to minimize tax. Complexity also acts like a lump-sum tax on anyone who has to prepare a tax return and has to figure out what to do. Complexity also has the effect of moving resources to non-economic professions like lawyering and accounting and lobbying—groups that tend to be fairly far up on the income ladder. It was interesting that both Dr. Boushey and I stressed the problem with rent seeking behavior. But it is the combination of high rates and complex rules that maximizes the reward to rent seeking at the cost of real and productive economic activity.

Question. Dr. Lindsey, you state that in recent decades income inequality grew the most when Presidents were seemingly trying to do the most to curb the growth of inequality. That is, efforts to curb growing inequality have backfired. But why would that be?

Answer. Having served in government over a span that encompassed three decades I have come to view the Law of Unintended Consequences as one of the most powerful there is. Speculating as to why it is so powerful is more difficult. My view is that when government tries to do something it does so in a way that makes the lives of ordinary individuals more complicated and also moves power from individuals to Washington. Thus ordinary individuals are more burdened, opportunity is reduced, and those "rent seekers" who make their living off of government imposed complexity are the big beneficiaries.

Question. Peter R. Orszag, former OMB director and former CBO director, published "To Fight Inequality, Tax Land" at the same time the hearing was scheduled to begin—9 AM, Tuesday, March 3. See *http://www.bloombergview.com/articles/2015-03-03/to-fight-inequality-tax-land.* Do you have any reaction to Dr. Orszag's article? In particular, please share any thoughts you have on this segment from the article: "Joseph Stiglitz . . . argu[es] that Piketty has misdiagnosed the problem of wealth and income inequality, including by ignoring the crucial role of land and housing. And as a result, Piketty's policy proposals may do more harm than good." Please share any thoughts you might have on this paragraph:

> Stiglitz also argues for imposing a land value tax, to directly address this source of increasing wealth inequality. Economists have long favored such a tax, because it does little or nothing to distort incentives: Since land is roughly fixed in supply, there's little one can do to escape a land tax. Indeed, from the perspective of economic efficiency, a land value tax scores higher than even a value-added tax, which is typically seen as the most efficient form of taxation.

Answer. Both Director Orzag and Professor Stiglitz are correct in pointing out the flaws in the Piketty argument. Serious economists have pointed out numerous statistical and analytical flaws in his approach. This has not seemed to diminish his attraction to the mainstream media however. Narrative tends to trump truth more and more these days. As to the land tax, I would note that this has traditionally been the province of local government and that land (and improvements) are taxed at a reasonable rate already. If one considers the real return to capital as about 5 percent, a 1 percent of value property tax (such as I face in Virginia) is roughly a 20 percent tax on the imputed income generated by that property. I know by experience that my late mother's tax on her house was closer to 2½ percent of value—the equivalent of a 50 percent tax. So I think that taking this into account is very important in the context of the case that Stiglitz and Orzag make.

PREPARED STATEMENT OF DEROY MURDOCK, FOX NEWS CONTRIBUTOR AND SENIOR FELLOW, ATLAS NETWORK

Good morning.

Thank you very much for inviting me here today. I am thrilled to participate, and especially delighted to appear before Chairman Hatch, for whom I interned while a student at Georgetown University. Who would have imagined 30 years ago, Mr. President pro tem, that we would be here today, in such elevated circumstances?

As I thought about today's topic, I imagined someone weighing two job offers: Company A offers $50,000, but the boss makes $55,000. That represents an income gap of just 10 percent. I think even the Occupy Wall Street people could live with that. Now Company B offers $500,000, but the boss makes $1 million. Imagine that! Income inequality of 100 percent. Who does the boss think he is?

Now would you prefer job offer A? How about job offer B? Most people would grab the half million dollars and laugh all the way to the bank—never mind the 100 percent income gap. And that's the point. Too much of our political rhetoric these days revolves around envy, resentment, and sometime even violence towards the affluent, all in an effort to take what they have and redistribute it to those who have less.

Obama's words from September 27, 2011 illustrate this point. He said: "If asking a millionaire to pay the same tax rate as a plumber makes me a class warrior—a warrior for the working class—I will accept that. I will wear that charge as a badge of honor."

The American Left has made plenty of hay about the notion that the wealthy do not pay "their fair share" of taxes. This is an exciting slogan. Too bad it is unsupported by facts. According to Internal Revenue Service data, in 2012, the top 1 percent of tax filers earned 21.9 percent of all adjusted gross income. They also paid 38.1 percent of all federal income taxes. That looks to me like more than their "fair share." The top 10 percent of earners made 47.9 percent of AGI and paid 70.2 percent of income taxes. What about the bottom 50 percent? They made 11.1 percent of AGI and paid just 2.8 percent of federal income taxes.

So, rather than berate top income earners, we should thank them for paying more than their fair share to keep Washington so generously funded. Rather than obsess over how to squeeze, humiliate, and punish the wealthy, let's focus on how to lift the incomes of those at the opposite end of the income distribution. Rather than drag the wealthy from their penthouses, let's figure out how to bring those on the sidewalk up to the third or fourth floor, and help them move up from there.

I would make three suggestions:

First, America needs a tax code that is geared towards dynamic, robust economic growth—the kind of expansion in national output that enriches the poor and middle class, as well as the affluent. I recommend scrapping the U.S. Tax Code in its 72,000-page splendor and replacing it with a flat tax. While this idea needs deeper study and proper scoring, the National Taxpayers Union has estimated, very roughly, that a 10 percent tax with no deductions paid by all American adults would generate about as much income as today's convoluted system. I call this the 0–10–100 Plan, and we can discuss it further, if you like. The fairest tax would be one universal rate. Everyone would pay his fair share.

Second, America's 35 percent corporate tax is the OECD's highest. This is absurd, self-destructive, and a national disgrace. The corporate tax should be slashed dramatically, if not scrapped altogether. Shrinking or eliminating the corporate tax would be a small price to pay for the far, far greater benefit of seeing American companies remain here, rather than move offshore and haul jobs with them. And if a far more competitive corporate tax system actually attracts foreign firms to relocate here, all the better for Americans, especially those with low incomes.

Third, disadvantaged Americans need to make themselves globally competitive. Good luck doing so with the often calamitous government schools that hermetically seal the minds of too many low-income and minority children. Higher standards, charter schools, and initiatives like the Washington, DC voucher program and the private Harlem Educational Activities Fund will help these children develop the intellects and skills that they need to prosper in a world where the Internet ships talent cross borders at the speed of light.

Thank you very much, Mr. Chairman, ranking member Wyden, and the other members of the Committee. I look forward to your questions and comments.

[From *The Wall Street Journal,* Updated November 20, 2014 8:42 a.m. ET]

WHAT THE INEQUALITY WARRIORS REALLY WANT

Confiscating Wealth is Ultimately About Political Power. Koch Brothers, No. Public-Employee Unions, Yes.

By John H. Cochrane

Progressives decry inequality as the world's most pressing economic problem. In its name, they urge much greater income and wealth taxation, especially of the reviled top 1% of earners, along with more government spending and controls—higher minimum wages, "living" wages, comparable worth directives, CEO pay caps, etc.

Inequality may be a symptom of economic problems. But why is inequality itself an economic problem? If some get rich and others get richer, who cares? If we all become poor equally, is that not a problem? Why not fix policies and problems that make it harder to earn more?

Yes, the reported taxable income and wealth earned by the top 1% may have grown faster than for the rest. This could be good inequality—entrepreneurs start companies, develop new products and services, and get rich from a tiny fraction of the social benefit. Or it could be bad inequality—crony capitalists who get rich by exploiting favors from government. Most U.S. billionaires are entrepreneurs from modest backgrounds, operating in competitive new industries, suggesting the former.

But there are many other kinds and sources of inequality. The returns to skill have increased. People who can use or program computers, do math or run organizations have enjoyed relative wage increases. But why don't others observe these returns, get skills and compete away the skill premium? A big reason: awful public schools dominated by teachers unions, which leave kids unprepared even to enter college. Limits on high-skill immigration also raise the skill premium.

Americans stuck in a cycle of terrible early-child experiences, substance abuse, broken families, unemployment and criminality represent a different source of inequality. Their problems have proven immune to floods of government money. And government programs and drug laws are arguably part of the problem.

These problems, and many like them, have nothing to do with a rise in top 1% incomes and wealth.

Recognizing, I think, this logic, inequality warriors go on to argue that inequality is a problem because it causes other social or economic ills. A recent Standard & Poor's report sums up some of these assertions: "As income inequality increased before the [2008 financial] crisis, less affluent households took on more and more debt to keep up—or, in this case, catch up—with the Joneses." In a 2011 *Vanity Fair* article, Columbia University economist Joe Stiglitz wrote that inequality causes a "lifestyle effect . . . people outside the top 1 percent increasingly live beyond their means." He called it "trickle-down behaviorism."

I see. A fry cook in Fresno hears that more hedge-fund managers are flying in private jets. So he buys a pickup he can't afford. They are saying that we must tax away wealth to encourage thrift in the lower classes.

Here's another claim: Inequality is a problem because rich people save too much. So, by transferring money from rich to poor, we can increase overall consumption and escape "secular stagnation."

I see. Now we need to forcibly transfer wealth to solve our deep problem of national thriftiness.

You can see in these examples that the arguments are made up to justify a preexisting answer. If these were really the problems to be solved, each has much more natural solutions.

Is eliminating the rich, to eliminate envy of their lifestyle, really the best way to stimulate savings? Might not, say, fixing the large taxation of savings in means-tested social programs make some sense? If lifestyle envy really is the mechanism, would it not be more effective to ban "Keeping Up With the Kardashians"?

If we redistribute because lack of Keynesian "spending" causes "secular stagnation"—a big if—then we should transfer money from all the thrifty, even poor, to all the big spenders, especially the McMansion owners with new Teslas and maxed-

out credit cards. Is that an offensive policy? Yes. Well, maybe this wasn't about "spending" after all.

There is a lot of fashionable talk about "redistribution" that's not really the agenda. Even sky-high income and wealth taxes would not raise much revenue for very long, and any revenue is likely to fund government programs, not checks to the needy. Most inequality warriors, including President Obama, forthrightly advocate taxation to level incomes in the name of "fairness," even if those taxes raise little or no revenue.

When you get past this kind of balderdash, most inequality warriors get down to the real problem they see: money and politics. They think money is corrupting politics, and they want to take away the money to purify the politics. As Berkeley economist Emmanuel Saez wrote for his 2013 Arrow lecture at Stanford University: "top income shares matter" because the "surge in top incomes gives top earners more ability to influence [the] political process."

A critique of rent-seeking and political cronyism is well taken, and echoes from the left to libertarians. But if abuse of government power is the problem, increasing government power is a most unlikely solution.

If we increase the top federal income-tax rate to 90%, will that not just dramatically increase the demand for lawyers, lobbyists, loopholes, connections, favors and special deals? Inequality warriors think not. Mr. Stiglitz, for example, writes that "wealth is a main determinant of power." If the state grabs the wealth, even if fairly earned, then the state can benevolently exercise its power on behalf of the common person.

No. Cronyism results when power determines wealth. Government power inevitably invites the trade of regulatory favors for political support. We limit rent-seeking by limiting the government's ability to hand out goodies.

So when all is said and done, the inequality warriors want the government to confiscate wealth and control incomes so that wealthy individuals cannot influence politics in directions they don't like. Koch brothers, no. Public-employee unions, yes. This goal, at least, makes perfect logical sense. And it is truly scary.

Prosperity should be our goal. And the secrets of prosperity are simple and old-fashioned: property rights, rule of law, economic and political freedom. A limited government providing competent institutions. Confiscatory taxation and extensive government control of incomes are not on the list.

[From the *National Review,* May 4, 2012]

IGNORE THE INCOME GAP

Rather Than Lift the Lobby, the Left Would Plunge the Penthouse

By Deroy Murdock

"Every time a bank fails an angel gets its wings." So goes a graffito in Manhattan's East Village. One block away, as marchers occupied Broadway on May Day, their picket signs proclaimed, "Millionaires must pay their fair share" and "No free ride for Wall Street." Lacking capital letters, another oddly stated: "i put all my books in the oven and i'll never read again."

Apart from that last, puzzling sentiment, the placards echoed Occupy Wall Street and its spiritual leader, President Barack Obama. Class warriors scream about imposing "fairness" on the rich, but their shouts become mumbles when asked what precise tax rate achieves "fairness."

Liberals fall mum amid these facts: In 2009, the latest IRS figures demonstrate, the much-maligned top 1 percent of taxpayers earned 17 percent of national income and paid 37 percent of federal income taxes. The top 10 percent made 43 percent of national income and surrendered 70.5 percent of income-tax revenues. Meanwhile, the bottom 50 percent scored 13.5 percent of national income and paid just 2.3 percent of income taxes.

Unfair? If so, the Left should specify what heavier tax burden on the wealthy or lighter tax load on the lower half of taxpayers would constitute "fairness."

“Fairness” evidently does not involve augmenting tax revenues, either to pay down the national debt or even to fund the social spending that makes liberals salivate.

As the Ethics and Public Policy Center’s Peter Wehner recalled April 12 in a superb essay on *Commentary*’s website, in 2008 then-Senator Obama advocated a higher capital-gains tax rate. He did so even though lowering that tax rate from 28 percent to 20 percent in 1997 actually expanded net revenues by 124 percent—from $54 billion in Fiscal Year 1996 to $121 billion in FY 2000, according to a Congressional Budget Office report. That tax-rate cut was enacted under tea-party pinup William Jefferson Clinton.

“Well, Charlie,” Obama told ABC’s Charles Gibson during the 2008 campaign, “what I’ve said is that I would look at raising the capital-gains tax for purposes of fairness.”

For too many liberals like Obama, “fairness” is not about enriching the modest; it’s about impoverishing the moneyed.

Multibillionaire Warren Buffett has energized liberals with his still-unverified claim that his tax rate lags his secretary’s. If that is true, “fairness” could mean slashing the secretary’s taxes to match Buffett’s 11 percent effective tax rate. (Like many 1 percenters, Buffett chooses to derive most of his income from lower-taxed investments rather than higher-taxed wages.) Somehow, reducing the secretary’s taxes never came up. Instead liberals demand the so-called Buffett Rule, an instrument for bludgeoning the successful rather than boosting the downtrodden.

In her final appearance in the British House of Commons, Prime Minister Margaret Thatcher skewered this liberal mindset. Feisty as ever, she answered her colleagues’ questions on the gap between the needy and the affluent: “The honourable gentleman is saying that he would rather that the poor were poorer, provided that the rich were less rich,” Thatcher explained on November 22, 1990. “So long as the gap is smaller, they would rather have the poor poorer. One does not create wealth and opportunity that way.”

Like Thatcher, American conservatives should reject the concept of the income gap. Who cares about the gap, provided that those on the bottom advance in absolute terms?

Consider two job offers: (a) You will earn $50,000, while your boss makes $55,000, just 10 percent more. (b) You will earn $500,000, while your employer gets $1 million—twice your salary. “Unfairness” suddenly looks spectacular.

Here’s how the Right should challenge the Left:

“If you dislike income inequality, lift those with the least. Let’s adopt universal school choice, allow personal Social Security retirement accounts (to democratize long-term capital accumulation), radically reduce or eliminate America’s anti-competitive 35 percent corporate tax (to supercharge businesses), and pass right-to-work laws (so the jobless won’t fester outside closed shops). Let’s build the Keystone Pipeline (to create 20,000 blue-collar positions right now and lower everyone’s energy costs), frack for natural gas, and tame the EPA, OSHA, SEC, and other power-mad bureaucracies, so U.S. companies will stay here, and foreign firms will move in.”

If liberals agree, they should enact this economic-growth agenda. If they do not, they should explain why they reject these proposals to help poor people prosper.

Most likely, the ensuing silence would reveal liberals’ true intentions: not to lift the lobby, but to plunge the penthouse.

[*National Review,* October 3, 2011]

Obama Proudly Declares Class War

But the Rich Already Are Getting Soaked

By Deroy Murdock

It’s official: America is at class war, and Pres. Barack Obama proudly leads the charge against this country’s wealthy.

"If asking a millionaire to pay the same tax rate as a plumber makes me a class warrior—a warrior for the working class—I will accept that," Obama shouted Tuesday at Denver's Abraham Lincoln High School. "I will wear that charge as a badge of honor."

"Middle-class families shouldn't pay higher tax rates than millionaires and billionaires," Obama said. "A teacher or a nurse or a construction worker making $50,000 a year shouldn't pay higher tax rates than somebody making $50 million."

These may be the harshest such comments that Obama has made, but they certainly are not the first.

- "The debt ceiling should not be something that is used as a gun against the heads of the American people to extract tax breaks for corporate-jet owners," Obama said on July 6.
- "We can't just tell the wealthiest among us, 'You don't have to do a thing. You just sit there and relax, and everybody else, we're gonna solve this [deficit] problem,'" Obama remarked on April 14.
- Most revealingly, Obama confessed on April 28, 2010: "I do think at a certain point, you've made enough money."

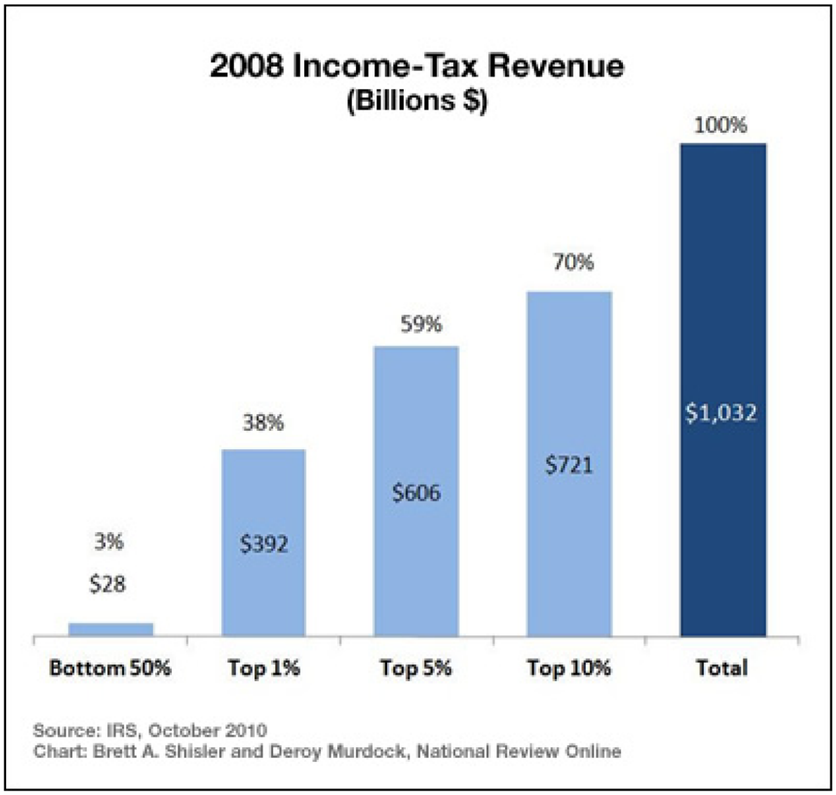
Obama's assault on the affluent rests upon a sky-high stack of lies. Obama is too well-staffed and too well-informed not to know otherwise. So, maddeningly, he straight-out lies to the American people.

For days before Obama opened his mouth in Denver, multiple news accounts and opinion pieces annihilated the *casus belli* of his War on the Wealthy. Nonetheless, Obama keeps spouting falsehoods, perhaps hoping that his smooth voice will hypnotize Americans into believing his words.

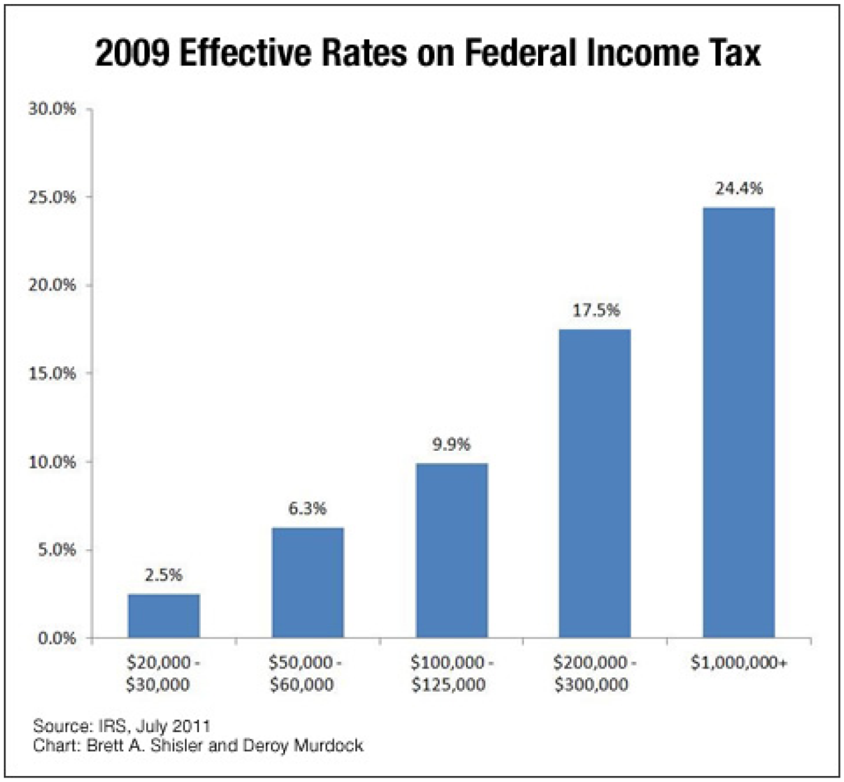
"Fact check: The wealthy already pay more taxes," read the headline above a September 20 Associated Press dispatch. "President Obama says he wants to make sure millionaires are taxed at higher rates than their secretaries," Stephen Ohlemacher wrote. "The data say they already are."

Nationwide, Ohlemacher and others dismantled Obama's soak-the-rich thesis. The rich are soaked *today*!

In 2008, its latest data indicate, the Internal Revenue Service harvested $1.0315 trillion in income tax—of which the bottom 50 percent of earners collectively paid just $27.9 billion. The top 1 percent paid $392.15 billion; the top 5 percent paid $605.7 billion; and the top 10 percent paid $721.4 billion. Thus, the top 1 percent of taxpayers furnished *14 times* the income taxes that the bottom 50 percent supplied.

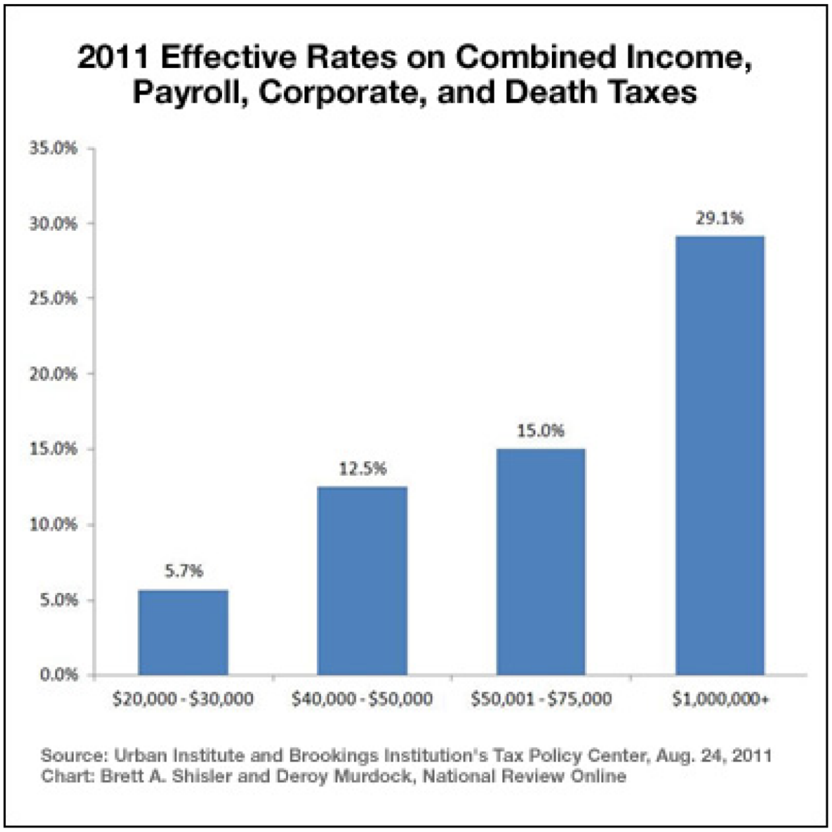


In 2009, the IRS reports, those who earned between $20,000 and $30,000 paid an average of 2.5 percent of adjusted gross income in federal income taxes. Those who earned between $50,000 and $60,000 paid 6.3 percent; between $100,000 and $125,000, 9.9 percent; between $200,000 and $300,000, 17.5 percent. Those who made at least $1 million saw income taxes devour 24.4 percent of AGI.



Income, schmincome, leftists chirp. What about the payroll taxes that lower-income Americans pay? Counting other taxes still shows that higher earners pay more—Obama's dark fantasies notwithstanding.

The Tax Policy Center—a joint venture of two liberal bastions, the Urban Institute and the Brookings Institution—reported on August 24 that Americans who earn between $20,000 and $30,000 will pay an average of 5.7 percent of their 2011 earnings in federal income, payroll, corporate, and death taxes. Those clearing between $40,000 and $50,000 will pay 12.5 percent, while those from $50,000 to $75,000 will average 15 percent. For earners of $1 million or more, those federal taxes will extract 29.1 percent.



Dry? Yes. But these figures demonstrate that Americans who earn more money pay more federal tax. Those who earn less pay less. If Obama finds this unfair, he should define fairness.

True, the IRS notes, 1,470 households earned at least $1 million but paid no federal income tax in 2009. Still, this is just 0.62 percent of the 236,883 returns that millionaires filed. This reinforces the bipartisan idea of closing loopholes and lowering tax rates—but not Obama's crusade against "millionaires and billionaires" and his American Jobs Act's tax hikes on people earning as little as $200,000.

All of this has started to irritate even some Democrats.

"You don't get people to like you by attacking them or demeaning their success," billionaire Democrat Robert Johnson said October 2 on Fox News Sunday. "You know, I grew up in a family of ten kids, first one to go to college, and I've earned my success. I've earned my right to fly private if I choose to do so. . . . I sort of take the old Ethel Merman approach to life. I've tried poor, and I tried rich, and I like rich better. It doesn't mean that I am a bad guy."

The founder of Black Entertainment Television added: "I didn't go into business to create a public-policy success for either party, Republican or Democrat. I went into business to create jobs and opportunity, create opportunity, create value for myself and my investors. And that's what the president should be praising, not demagoguing us simply because Warren Buffet says he pays less [taxes] than his secretary. He should pay the secretary more, and she will pay more."

"With my investments and board seats and companies that I own, I am at a leadership position in concerns that employ more than 200,000 people," Ted Leonsis, owner of the Washington Wizards basketball team, wrote on September 25. "We do

our best to be good corporate citizens. I know in the companies that I own personally, or am the largest shareholder, we support more than 500 charities."

"I voted for our President," continued Leonsis, who also owns the Washington Capitals hockey team. "I have maxed out on personal donations to his re-election campaign. I forgot his campaign wants to raise $1 billion. THAT is a lot of money-money-money-money! Money still talks. It blows my mind when I am asked for money as a donation at the same time I am getting blasted as being a bad guy!"

"Someone needs to talk our President down off of this rhetoric about good vs. evil; about two classes and math," Leonsis concluded. "Many of us want to be a part of the solution. We aren't the problem."

When Obama accepted the 2008 Democratic nomination in Denver, he espoused national unity. The U.S.A. would "come together as one American family," he declared. If Barack Obama secured the presidency, he suggested, the nearby Continental Divide would become this republic's only rift.

How disappointing that the eloquent man who millions hoped would heal this land now actively pits Americans against each other—not by race or creed, but by income. As London's arson-scorched victims of mob rule learned last August, there is nothing cute about class war.

—New York commentator Deroy Murdock is a nationally syndicated columnist with the Scripps Howard News Service and a media fellow with the Hoover Institution on War, Revolution, and Peace at Stanford University. Manhattan financier Brett A. Shisler contributed to this piece.

[*National Review,* December 23, 2010]

MERRY CHRISTMAS TO AMERICA'S TOP 1 PERCENT

The Rich Are More like Santa Than Scrooge

By Deroy Murdock

In this season of giving, the words hurled at America's wealthiest citizens have been far from generous.

The recent debate over the Obama-GOP tax-cut compromise featured language best described as "affluphobic."

Senator Bernie Sanders of Vermont, a self-styled socialist, spent nearly nine hours on December 10 excoriating affluent Americans. Sanders complained to colleagues that "when the rich get richer . . . they say: 'I am not rich enough. I need to be richer.' What motivates some of these people is greed and greed and more greed." Sanders further filibustered: "Greed is, in my view, like a sickness. It's like an addiction. We know people on heroin. They can't stop. They need more and more."

Sanders wailed that the top 1 percent of taxpayers (who made more than $380,354 apiece) earned 20 percent of America's Adjusted Gross Income (AGI) in 2008, according to IRS data analyzed by the Tax Foundation. True. They also paid 38 percent of all federal income taxes. The top 5 percent (with incomes exceeding $159,619) earned 34.7 percent of AGI and paid 58.7 percent of taxes. The top 10 percent (with incomes above $113,799) earned 45.8 percent of AGI and paid 69.9 percent of federal income taxes.

So, do these rich people pay their "fair share?" If not, should the top 10 percent finance 75 percent of income taxes? Eighty percent?

In contrast, the bottom 50 percent of taxpayers generated 12.8 percent of AGI and paid 2.7 percent of all federal income taxes.

High-income taxpayers also cough up state and local levies and often pay taxes on sales, property, capital gains, dividends, partnerships, and corporate income. Their wealth floods public coffers and flows into government programs, many targeted at low-income Americans.

So what? Generosity is a snap when tax authorities demand tribute. How do the rich behave absent government coercion?

"These people who are worth hundreds of millions of dollars," Sanders stated on the Senate floor, "maybe they've got to go back to the Bible or whatever they believe in understanding that there is virtue in sharing, in reaching out, that you can't get it all."

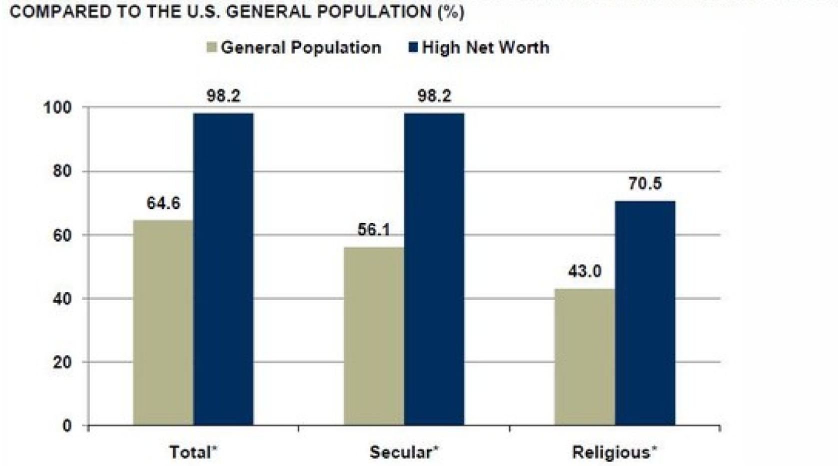
Sanders should appreciate these IRS data:

To be surgically precise, as Ryan Ellis of Americans for Tax Reform notes, an IRS review of Returns with Itemized Deductions (columns CI and CJ) indicates that in tax year 2008, Americans who earned at least $200,000 filed 3,912,225 tax returns or 9.96 percent of that year's 39,250,369 total returns. This group deducted $72,336,640,000 in charity, or 41.83 percent of the $172,936,002,000 for such deductions that all filers claimed. In short, the top 10 percent of taxpayers paid 42 percent of all charitable deductions, worth $72 billion in 2008 alone.

To understand wealthy Americans' "virtue in sharing," consider *The 2010 Bank of America Merrill Lynch Study of High Net Worth Philanthropy*. Conducted by Indiana University's Center on Philanthropy and released November 9, this fascinating document (recommended by the National Taxpayers Union's Andrew Moylan) finds rich people doing what Senator Sanders asked.

This survey included 801 respondents who made at least $200,000 and/or enjoyed at least $1 million in net worth, excluding housing. The average respondent was worth $10.7 million.

FIGURE 17: PERCENTAGE OF HIGH NET WORTH HOUSEHOLDS WHO GAVE TO CHARITY IN 2009, COMPARED TO THE U.S. GENERAL POPULATION (%)



Among these multi-millionaires, 98.2 percent contributed to charity, versus just 64.6 percent of the general population. The wealthy typically gave away about 8 percent of their incomes in 2009. This figure has slipped as the economy has slid. In 2007's survey, the rich donated between 9.3 percent and 16.1 percent of income.

In 2009, 26.8 percent of Americans volunteered with charitable organizations. However, 78.7 percent of wealthy people volunteered—nearly triple the national figure. The average rich respondent volunteered 307 hours. Rather than merely write checks, the average wealthy American last year gave to charity the equivalent of 38 eight-hour shifts.

The Center on Philanthropy's researchers valued each hour of voluntarism at $20.85. So, the average rich American's 307 volunteer hours equaled $6,400.95.

"High net worth households play an important role in the philanthropic landscape," the Bank of America study concluded. "They give between 65 and 70 percent of all individual giving and between 49 and 53 percent of giving from all sources, which includes giving from corporations, foundations, and both living and deceased individuals."

Some highly wealthy individuals give enough to rename entire institutions after themselves. New York University's Medical Center was rechristened the NYU

Langone Medical Center after venture capitalist (and plumber's son) Ken Langone donated $200 million without restrictions in 2008.

That same year, Lincoln Center's New York State Theater was redubbed the David H. Koch Theater after the businessman and free-market activist contributed $100 million to renovate the New York Ballet's home stage.

Nonetheless, some remain utterly unimpressed with America's wealthy. According to Cape Cod cops and fire investigators, on November 24, an arsonist torched a $500,000 house under construction in Sandwich, Mass. On December 2, an arson attempt almost destroyed a Marston's Mills home. At both crime scenes, someone graffitied "F— the rich."

On December 14, Clay Duke opened fire on a Panama City, FL, school board meeting before fatally shooting himself. His online "last testament," linked to left-wing websites, including WikiLeaks and mediamatters.org, and echoed today's anti-rich themes.

"I was just born poor in a country where the Wealthy manipulate, use, abuse, and economically enslave 95% of the population," Duke wrote. "Our Masters, the Wealthy, do as they like to us."

While most wealthy people acquire their money legally, greedy crooks like Bernie Madoff exist, alas, and should be imprisoned and impoverished. Also, capitalism should be cleansed of the bailouts, subsidies, and special favors that perversely find roofers and waitresses underwriting financiers and speculators.

But these are exceptions, not the rule. Despite today's destructive anti-rich slogans, the data demonstrate that wealthy Americans are much less like Scrooge and much more like Santa.

—Deroy Murdock is a nationally syndicated columnist with the Scripps Howard News Service and a media fellow with the Hoover Institution on War, Revolution and Peace at Stanford University.

QUESTIONS SUBMITTED FOR THE RECORD TO DEROY MURDOCK

QUESTIONS SUBMITTED BY HON. ORRIN G. HATCH

Question. Mr. Murdock, this question is for you. In your testimony, you mention that the President has explicitly called himself a "class warrior." You also go on to state that some political rhetoric revolves around violence towards the affluent. Can you elaborate? Many politicians engage in a bit of hyperbole now and then—do you think some of this rhetoric has become excessive?

Answer. Yes, some politicians engage in florid and feverish rhetoric. However, some comments have gone beyond that and actually involve threats of or references to violence. For instance:

- "The debt ceiling should not be something that is used as a gun against the heads of the American people to extract tax breaks for corporate jet owners."

When Obama said this on July 6, 2011, it seemed rather odd, especially after the shooting of then-Rep. Gabby Giffords (D–Arizona) and 18 others (six fatally) that January 8.

- San Francisco area rapper Boots Riley sings a song called "5 Million Ways to Kill a CEO." Its lyrics are horrid:

  "Toss a dollar in the river, and when he jump in
  "If you find he can swim
  "Put lead boots on him and do it again."

- Actress and comedienne Rosanne Barr said this in October 2011:

"I first would allow the guilty bankers the ability to pay back anything over $100 million personal wealth, because I believe in a maximum wage of $100 million. And if they are unable to live on that amount, then they should go to the re-education camps, and if that doesn't help then be beheaded."

One wonders if Barr's proposal also applies to her fabulously wealthy friends in Hollywood.

- A man named Clay Duke held the Panama City, Florida, school board at gun point in December 2010 before turning the gun on himself. Police found his online manifesto. It read, in part:

"I was just born poor in a country where the Wealthy manipulate, use, abuse, and economically enslave 95% of the population . . . Our Masters, the Wealthy, do as they like to us."

- Five anarchists, including three members of Occupied Cleveland, were arrested in May 2012 in an alleged plot to blow up a bridge in Ohio. The April 30, 2012 affidavit of FBI Special Agent Ryan Taylor said that these men wanted "to make sure everyone knows that the action was against corporate America and the financial system, and not just some random acts."

Question. Mr. Rattner, in his testimony, referred to certain high-value Individual Retirement Accounts as an "abusive practice." Now, it is certainly true that successful investment returns for an IRA owner after the legally permitted contribution has been made can lead to above-average IRA balances. But there is no sound policy justification for punishing taxpayers merely for successful investment results. And successful investing is certainly not an "abusive practice." In fact, in 1997 Congress repealed an excise tax on "excess" retirement accumulations. Congress determined on a bi-partisan basis that limits on contributions were a sufficient limitation on tax-deferred savings and that additional penalties were not necessary. The excess retirement accumulation tax was repealed, with bipartisan support, because it inappropriately penalized favorable investment returns. Penalizing favorable investment returns is a policy to which Congress should not return. Do you have a comment on whether successful investing is an abusive practice? To say something is an abusive practice suggests that it is wrong and that the government should punish it. What do you think?

Answer. I found Mr. Rattner's comment rather startling. He did not present, nor have I seen, any evidence that Mitt Romney engaged in any subterfuge that would qualify his high investment returns as an "abusive practice." Unless Romney, or anyone else, engages in illegal or unethical investment practices, such high returns—by themselves—do not deserve such slanderous vilification.

Indeed, by this measure, one could ask if Bill Gates' initial investment in Microsoft ($16,005, as measured by its first year's revenues) is "abusive," given that he now is worth $79 billion. Warren Buffet and Mark Zuckerberg are just two among many entrepreneurs who have turned small amounts of seed capital into vast fortunes and created tremendous wealth, value, innovation, and job opportunities for thousands, perhaps millions, of people along the way.

Government should do nothing whatsoever to limit healthy returns on investment, even up to levels that some might consider "abusive," so long as investors behave legally and ethically. If they violate the law, "cuff 'em." If they generate impressive returns through their investment prowess and good luck, applaud them, learn from them, and ask to borrow their rabbits' feet.

Question. In reviewing today's testimony and the dialogue between members and witnesses, you could get the impression that Democrats are solely concerned with vertical equity. Vertical equity is measurement of the tax burdens among income cohorts. Distribution tables are treated as a fetish. Republicans, on the other hand, are delving into the issue of horizontal equity. I find it curious that Finance Committee Democrats weighed in on aspects of horizontal equity in a letter to the Chairman, dated January 29, 2015. The sentence is as follows: "Any reform package must take into account the varying cost of living differences among States and regions, and ensure all middle class families are protected regardless of where they live." Should we exclusively look at distribution tables?

Answer. It is not a good idea to worship distribution tables. For that matter, Democrats and liberals tend to focus excessively on income gaps between those with high incomes and those less fortunate. The usual thrust of their approach is to vilify the wealthy, make them feel guilty about their incomes, and then punish them through high taxes and regulations as some sort of means to advance social justice. Income gaps assume that an economic snapshot taken today will look exactly the same in 2, 5, 10, or 20 years. People move up and down the income distribution, based on changing education levels, the overall economic climate, their own shifting family circumstances, and many other factors. Rather than drag the wealthy off of their yachts, let's get the poor off the figurative docks, into rowboats, and move them up into motorboats, speedboats, and eventually into yachts of their own. Ro-

bust economic growth fosters maximum upward economic mobility. Creating a favorable atmosphere for such expansion should be the goal of public policy.

Question. Mr. Murdock, you state in your testimony that we could likely raise the same amount of revenue as we do currently with the individual income tax by simply having a 10% flat tax on all income. And, in fact, we heard just recently from former Finance Committee Chairman Bob Packwood something very similar—he said we could raise the same amount of money as we do currently by having an 11% flat income tax. My question for you is: Do you think the American people would ever support such a thing? Do you have any rough estimates as to what percentage of the income tax the bottom 50% would then be bearing? Or of the top 1%? Would such a flat 10% tax be fair?

Answer. First, here are some rough estimates of the revenue that would be generated by my proposed 0–10–100 Tax (Zero deductions, a 10 percent flat rate on all income, paid by 100 percent of American adults). Based on the Tax Foundation's December 2014 Summary of Federal Income Tax Data for 2012 (the latest available figures), the results would look something like this:

(Dollars in millions)

Category	AGI	Tax Paid in 2012	Tax Paid Under the 0–10–100 Tax
Top 1%	1,976,388	451,328	197,638
Top 10%	4,327,899	831,455	432,789
Bottom 50%	1,003,944	32,915	100,394

I think this would be a fair tax structure. Everyone would pay "his fair share"—10 percent of income, regardless of source. Zero deductions would make it impossible for wealthy people to hide their income inside the bitter honeycomb that is the *U.S. Tax Code.* And 100 percent of American adults would pay into the system, even if they receive much more in public assistance and benefits than they make in tax payments. However, this would maximize civic participation, and everyone would have "skin in the game," rather than something north of 40 percent of American tax filers not paying any tax.

The chief benefit of such a tax system would be roaring economic growth. Such a low, simple, and predictable tax system—especially if it is mirrored with a 0–10–100 Corporate Tax—would spur business output and attract foreign capital from people wanting to do business here. That would be a huge boon for the unemployed and those with low incomes.

Would the American people ever support such a radical reform of the tax system? This depends entirely on the willingness of free-marketeers in and out of office to exercise the leadership to promote this idea. If conservatives and Republicans run and hide as soon as liberals and Democrats scream their class-warfare slogans, this will go nowhere. If, however, free-marketeers explain in an understandable fashion why this would be such a massive improvement over today's calamitous tax code, the public could be rallied to support this system. I think those who pay little to no federal income tax today would be willing to pay more if they knew that everyone had to pay, no one could hide behind endless and senseless deductions, and a low 10 percent tax rate would stimulate badly needed, dramatic economic growth.

Who knows? Such courageous leadership might attract the support of liberals and Democrats who say that they believe in fairness and helping the poor.

Question. Peter R. Orszag, former OMB director and former CBO director, published "To Fight Inequality, Tax Land" at the same time the hearing was scheduled to begin—9 AM, Tuesday, March 3. See *http://www.bloombergview.com/articles/2015-03-03/to-fight-inequality-tax-land.* Do you have any reaction to Dr. Orszag's article? In particular, please share any thoughts you have on this segment from the article: "Joseph Stiglitz . . . argu[es] that Piketty has misdiagnosed the problem of wealth and income inequality, including by ignoring the crucial role of land and housing. And as a result, Piketty's policy proposals may do more harm than good." Please share any thoughts you might have on this paragraph:

> Stiglitz also argues for imposing a land value tax, to directly address this source of increasing wealth inequality. Economists have long favored such a tax, because it does little or nothing to distort incentives: Since land is roughly fixed

> in supply, there's little one can do to escape a land tax. Indeed, from the perspective of economic efficiency, a land value tax scores higher than even a value-added tax, which is typically seen as the most efficient form of taxation.

Answer. I see no need for a land-value tax, especially at the federal level. Landowners already pay local, county, and (possibly) state property taxes. Other than squeezing these people for more money, there is no sense in ladling on another tax for them to pay.

Such a tax would not apply to those who own no land. This would create another schism between the "pays" and the "pay nots." Rather than divide America further, we should tax either income or consumption and do so on an equal basis.

As mentioned above, it also is vital that every American adult pay some tax on income (or, eventually, consumption), so that everyone has "skin in the game." The CIA, FBI, FDA, NPR, Secret Service, and the Washington Monument truly should belong to all of us, not just those who happen to pay taxes. Removing Americans from the tax rolls creates this "no skin in the game" situation. It also makes it very easy for people to back politicians and causes—mainly on the Left—who support generous public benefits and services financed by those who pay taxes. Once those who do not pay into the system can vote for goodies financed by those who do, we will travel further along the road to serfdom. Orszag's scheme would speed us even more miles down that grim path.

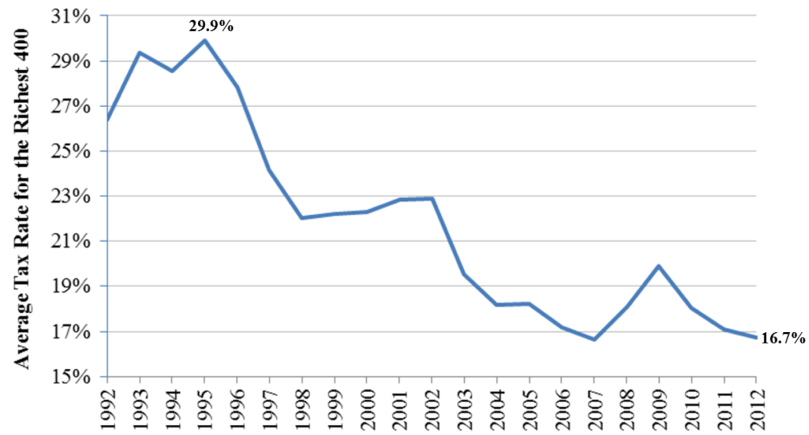
Prepared Statement of Steven Rattner, Chairman, Willett Advisors LLC

Next year will mark the 30th anniversary of the last major piece of tax reform legislation that has been passed by Congress and signed into law. While there have been many adjustments in the code since then, it has been far too long since a thorough overhaul was undertaken.

Ensuring a fair and effective tax code is a bit like maintaining a garden: Without constant watering and weeding, it will quickly deteriorate as lawyers and accountants find new ways to legally—but unfairly—ease their clients' tax burdens.

Consider, for example, the tax rates borne by the wealthiest Americans. In 1995, the 400 highest income Americans paid just under 30% of their adjusted gross incomes in taxes. By 2012, the most recent year available from the Internal Revenue Service, the tax rate for this same cohort had dropped to 17%.

Taxes for the Richest 400 Go Down

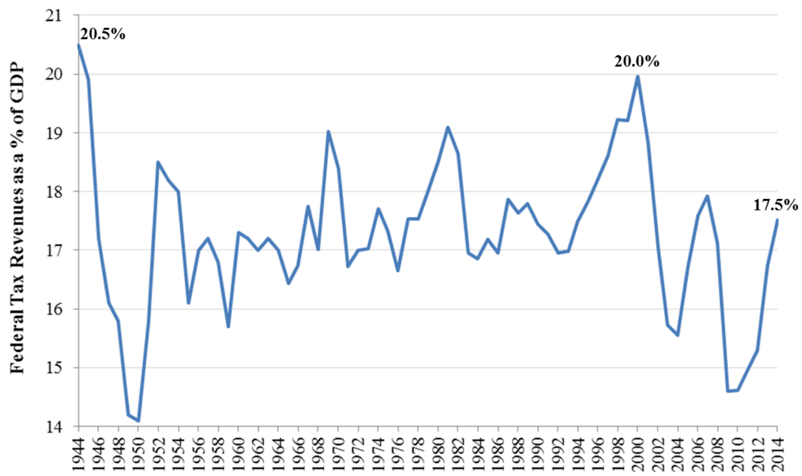


Source: IRS

Not all of that drop is due to clever tax manipulation; some resulted from lowering of rates on ordinary income, while most came from low rates on income from capital gains and dividends. (In fairness, the tax rate of this mega-rich cohort is likely to have gone up in recent years following the increase in the capital gains rate for the wealthy beginning in 2013.)

Meanwhile, after plunging to low levels during the financial crisis and recession, tax collections as a share of gross domestic product have recently risen to 17.5%, still at the low end of the historic band of 17% to 19%.

Fluctuating Tax Revenues



Source: CBO

To be fair, many of the most important changes made by the 1986 law have succeeded in reining in the most egregious tax avoidance schemes that operated prior to the law's passage.

But other abusive practices remain. We learned, for example, during the last Presidential campaign that one of the candidates was able to amass an Individual Retirement Account with a balance that he listed at $20.7 million to $101.6 million. That occurred in the context of maximum allowed total contributions during the relevant years on the order of $500,000.

Another well-publicized loophole is the ability for private equity and certain hedge fund operators to have their carried interest proceeds taxed as capital gains. At various points in my career (including at present), I have been a substantial beneficiary of these provisions and for the life of me, I can't understand why my tax rate on income from these activities was less than half of the tax rate paid by friends in other parts of the financial services industry.

Other provisions allow private equity professionals to convert ordinary income from management fees into lower taxed capital gains on their investments.

While the amounts of lost revenue to the Treasury from some of these mechanisms may not be huge, the significant attention around them contributes to resentment and a feeling on the part of average Americans that they are bearing an unfair burden.

It is true that by some measures, the progressivity of the tax code has increased in recent years, particularly because of tax reductions for those at the very bottom that have resulted in 41% of Americans paying no Federal income tax in 2014.

However, as we all know, pre-tax income inequality is currently at record levels. That disturbing trend should be considered by this Committee as it examines new tax proposals. Since the income tax was instituted in 1913, a bedrock principle has been that those Americans with higher incomes should pay higher rates.

There is no rulebook for what the appropriate amount of progressivity should be, and I accept the notion that at some high level, confiscatory taxes can discourage work. But in my 32 years on Wall Street, I have experienced top marginal Federal tax rates as high as 50% and as low as 28%, and I never detected any change in the motivation to work on the part of myself or any of my colleagues.

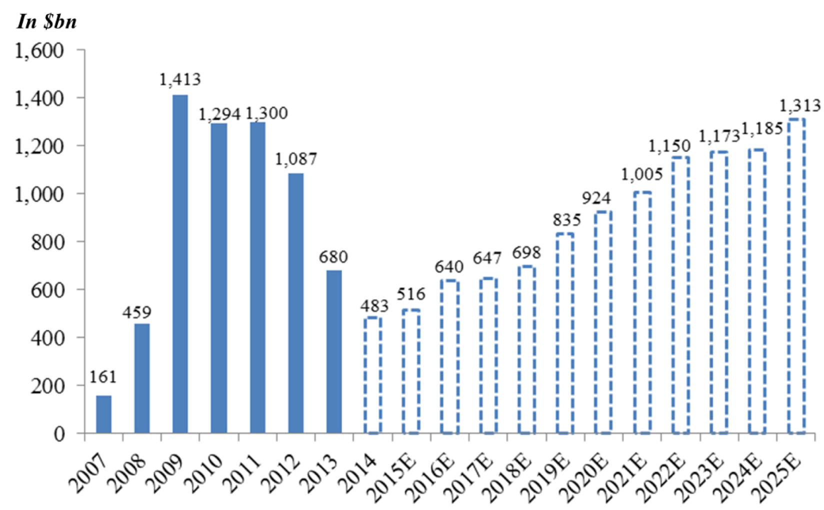
Similarly, the tax rate on long-term capital gains has ranged from 35% in the 1970s to 15%. A tax rate of at least 28% on this type of income would be appropriate.

In that regard, it is important to remember that the 1986 law provided that capital gains would be taxed at the same rate as ordinary income, a principle to which we should endeavor to return.

The cost of this tax expenditure is substantial—on the order of $120 billion per year. Only the exclusion from AGI of employer-provided health care costs the Treasury more.

In addition to achieving greater fairness, we need more revenue. While our budget deficit has come down rapidly, all reasonable forecasts show that at some point it will turn back up, particularly as the cost of retirement and health care costs for those of my baby boomer generation begin to mount.

Deficits Projected to Rise



Note: Figures are adjusted for war spending drawdown
Source: CBO Alternative Fiscal Scenario, CRFB

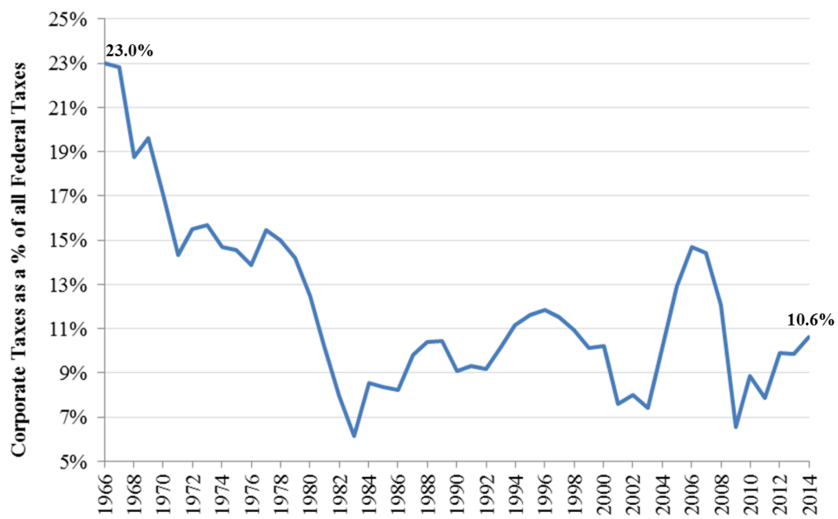
I do not believe that society will accept the reduction in these benefits necessary to maintain fiscal prudence nor do I believe that further cuts in real discretionary spending would be appropriate—indeed, outlays on many of these items should be increased.

While I was asked to focus my remarks on tax code fairness as it relates to individuals, no discussion of taxes and fairness would be complete without at least mentioning the sorry state of our corporate tax provisions.

Few policy issues engender such unanimity as the consensus that the tax code as it relates to business is riddled with loopholes, drives business out of the United States instead of encouraging it to locate here and creates such divergent outcomes as to make the individual provisions look like a paragon of equity.

In particular, the rampant use of inversions and earnings stripping and the even more rampant abuse of transfer pricing have contributed to a massive decline in the contribution of business tax revenues to the overall Federal tax revenues of the United States. In 1966, corporate taxes accounted for 23% of all Federal tax revenue; by 2014, just 10.6%.

Declining Share of Corporate Tax Revenues



Source: CBO

A good starting off point for the committee would be the exhaustive work of the Simpson-Bowles Commission, which much like the 1986 law, proposed reducing the number of tax rates to three, erasing the special treatment of capital gains and dividends, and eliminating most other tax deductions.

Many other meritorious plans have been put forth, such as the proposal made by Senators Wyden and Coats in 2011.

In his recent budget, President Obama proposed a few smaller changes that are worthy of the Committee's consideration, including a modest increase in the tax rate on capital gains and dividends and eliminating the step up in basis on assets held at death.

The President also proposed a variety of measures to provide tax relief for the middle and working class Americans, importantly including expansion of the Earned Income Tax Credit. As the Committee considers both tax fairness and adequate revenues, its review should encompass changes that would benefit Americans whose incomes have not been raised by the economic recovery.

QUESTIONS SUBMITTED FOR THE RECORD TO STEVEN RATTNER

QUESTIONS SUBMITTED BY HON. ORRIN G. HATCH

Question. Mr. Rattner, you mentioned that the Tax Reform Act of 1986 provided that capital gains should be taxed at the same rates as ordinary income and you advocate returning to that. Does that mean you are advocating taxing ordinary income at a top rate of 28% again? Or, does that mean you are advocating taxing capital gains at rates as high as 39.6% (or even higher), as is the case for ordinary income now? In answering this, please keep in mind that the non-partisan Joint Committee on Taxation staff has told us that the revenue maximizing rate for capital gains is 28%. They have said that a capital gains tax rate exceeding 28% will actually get less revenue for the government than a capital gains tax rate of 28%.

Answer. I recognize there is a revenue maximizing level for capital gains tax rate, particularly if it is raised in isolation. However, not every expert agrees that 28% is the upper limit. As I noted in my testimony, the capital gains tax rate was 35%

in the 1970s so I would recommend raising it to 28–30% while maintaining the Affordable Care Act surtax of 3.8% on investment income. As I also noted in my testimony, equalizing the long-term capital gains/dividends rate and the ordinary income rate is a worthy objective.

Question. Mr. Rattner, in your testimony you refer to certain high-value Individual Retirement Accounts as an "abusive practice." Now, it is certainly true that successful investment returns for an IRA owner after the legally permitted contribution has been made can lead to above-average IRA balances. But there is no sound policy justification for punishing taxpayers merely for successful investment results. And successful investing is certainly not an "abusive practice." In fact, in 1997 Congress repealed an excise tax on "excess" retirement accumulations. Congress determined on a bi-partisan basis that limits on contributions were a sufficient limitation on tax-deferred savings and that additional penalties were not necessary. The excess retirement accumulation tax was repealed, with bipartisan support, because it inappropriately penalized favorable investment returns. Penalizing favorable investment returns is a policy to which Congress should not return. Are you advocating that Congress penalize favorable investment returns? Can you explain to the Committee what the abuse was that you referred to?

Answer. I certainly don't advocate penalizing good investors. In my testimony, I gave the example of Mitt Romney's IRA. It defies any logic that his massive IRA could have resulted from conventional asset appreciation as opposed to transfer of assets to the IRA at values significantly below their intrinsic value. For example, he likely sold some illiquid Bain investments to his IRA at substantial discounts—thereby effectively increasing his IRA contribution. In addition, he may well have sold some of his Bain carried interest to his IRA. If he did so at the outset of the fund, he likely put little or no value on that transfer even though it was worth millions. The Romney example is, in my experience, by no means an isolated example of these sorts of abusive practices.

Question. In reviewing today's testimony and the dialogue between members and witnesses, you could get the impression that Democrats are solely concerned with vertical equity. Vertical equity is measurement of the tax burdens among income cohorts. Distribution tables are treated as a fetish. Republicans, on the other hand, are delving into the issue of horizontal equity. I find it curious that Finance Committee Democrats weighed in on aspects of horizontal equity in a letter to the Chairman, dated January 29, 2015. The sentence is as follows: "Any reform package must take into account the varying cost of living differences among States and regions, and ensure all middle class families are protected regardless of where they live." Should we exclusively look at distribution tables?

Answer. Good tax policy should focus on both horizontal and vertical equity. I did not mean to leave the impression that horizontal equity is not important. Indeed, my comments about equalizing capital gains/dividends rates and ordinary income rates are per my view that people with similar incomes should pay similar amounts in taxes. That said, as a practical matter, not every tax expenditure will get eliminated and therefore achieving perfect horizontal equity would be an unrealistic goal.

With respect to the question of different costs of living between states and regions, I do not believe the tax code should attempt to adjust for this phenomenon beyond maintain the deductibility of state and local taxes.

Question. Peter R. Orszag, former OMB director and former CBO director, published "To Fight Inequality, Tax Land" at the same time the hearing was scheduled to begin—9 AM, Tuesday, March 3. See *http://www.bloombergview.com/articles/2015-03-03/to-fight-inequality-tax-land.* Do you have any reaction to Dr. Orszag's article? In particular, please share any thoughts you have on this segment from the article: "Joseph Stiglitz . . . argu[es] that Piketty has misdiagnosed the problem of wealth and income inequality, including by ignoring the crucial role of land and housing. And as a result, Piketty's policy proposals may do more harm than good." Please share any thoughts you might have on this paragraph:

> Stiglitz also argues for imposing a land value tax, to directly address this source of increasing wealth inequality. Economists have long favored such a tax, because it does little or nothing to distort incentives: Since land is roughly fixed in supply, there's little one can do to escape a land tax. Indeed, from the perspective of economic efficiency, a land value tax scores higher than even a value-added tax, which is typically seen as the most efficient form of taxation.

Answer. I agree that a land tax is an efficient form of taxation and overwhelmingly supported by economists. It also seems like a bipartisan proposal in that it

is progressive and does not discourage work (by taxing labor) or savings (by taxing capital). But despite all its merits, it would be politically difficult to implement. For one thing, landowners would certainly not want to face new taxes and as a result, lower sales prices. There will also be concerns about how the tax relates to the ability of landowners to pay and how it interacts with existing property taxes. If a land tax is based on square footage, it might encourage people to build up instead of out (resulting in excessively tall apartment buildings and even malls). So while great in theory, a land tax is not very feasible in practice.

PREPARED STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON

If there's a common economic theme to take away from the town halls and meetings I hold in Oregon, it's that people feel stuck. They worry about being able to afford necessities like childcare and college tuition. They say they're struggling to make ends meet, and they're unable to save.

The fact is, people fear more than a daunting climb up America's economic ladder of opportunity. They fear losing hold of the rungs and sliding back into hardship. And the numbers show why. For fifteen years, America's middle class has been shrinking for the wrong reason. People are falling out of the middle class, not moving upward.

No single piece of legislation will turn that around, but in my view, tax reform can help. As deeply flawed as the tax code may be, it reflects many of the country's most significant economic goals. There are policies designed to spark innovation and investment and help create high-wage, high-skill jobs. There are policies that fund our safety net, health care, and social security programs. Most importantly, there are policies that help hard working people grab the rungs and climb America's economic ladder.

So the challenge of tax reform can go one of two ways. The first option is to forget those important goals and make lowering rates the overriding objective. But that would leave the middle class hanging without the means to achieve the American dream of owning their home, save for a secure retirement and see their kids achieve a better future. The better option is to fix the tax code and accomplish our goals more effectively—to build a stronger economy and help more Americans climb the economic ladder.

That's the option I prefer. It's the fairest route to a smarter and more efficient system. An unfair tax reform plan would risk heaping a new burden on people who are already struggling to get ahead.

Recently, there has been discussion that not enough people are pitching in and paying taxes. It focuses on Americans of modest means who aren't hit by the income tax. Let's unpack that for a moment and think about a young veteran just coming home from serving our country overseas. Let's say for the sake of discussion that this vet has health problems, and as soon as he gets home, the bills start piling up.

He's fighting against a current that's forced a lot of vets into extreme hardship—some have even wound up sleeping in the woods in Oregon. But he's doing his best to grab the rungs and climb the economic ladder, and he's certainly chipping in by paying excise taxes. When he finds a job, at a minimum, there are payroll taxes. That vet's doing his part. And one of the tenets of the income tax has always been that it's paid by people who can afford it.

So to build a fairness agenda in tax reform, let's look back at how the last overhaul worked. The day President Reagan signed the '86 Tax Reform Act into law was a landmark day for fairness. President Reagan celebrated the fact that reform spared six million Americans from having to pay any income taxes. Six million! President Reagan called it, ". . . the best jobs creation bill, the best antipoverty legislation, and the best pro-family legislation the U.S. Congress has ever produced."

So let's try to meet the standard of fairness President Reagan set. I want to hone in on two important things the '86 act did, both of which should happen again. First, it gave fair treatment to wage earners, instead of punishing them by taxing their income at higher rates than others. And second, it cracked down on tax cheats who pry open loopholes and skirt their responsibilities.

Today I'm releasing a report that sheds light on some of the most egregious tax loopholes around: "wash sales" and "options collars" disguising income—"swap con-

tracts” shielding gains. Sophisticated taxpayers are able to hire lawyers and accountants to take advantage of these dodges, but hearing about these loopholes must make middle-class taxpayers want to pull their hair out.

For people having a hard time or just making their way as best they can, it must feel like the tax system is rigged to make the other guy’s climb up America’s economic ladder easier than theirs.

The 1986 Tax Reform Act went a long way to changing that, and the Senate version of that bill passed with 97 votes. That’s a bipartisan route that Congress should take again: A tax reform plan built on fundamental fairness that makes it easier for everybody to climb America’s economic ladder of opportunity. I look forward to discussing that with our witnesses here today.

COMMUNICATIONS

LETTER SUBMITTED FOR THE RECORD BY DIXIE HICKMAN COLE

16 Darryl Place
Gymea Bay, N.S.W, 2227
Australia
2 March 2015

Senate Committee on Finance
Attn. Editorial and Document Section
Rm. SD–219
Dirkson Senate Office Bldg.
Washington, DC 20510–6200
Fax: 0011–1–202–228–0554

To Whom It May Concern:

I was born in the U.S. and came to Australia after University on a teacher's contract. I met my husband and decided to immigrate. I have had my full teaching career here, as well as my family of 2 daughters and now they have married and I have 2 grand-sons. I decided after the same number of 22 years living in Australia as I had the U.S., to become an Australian citizen. My life is fully here now. Both my parents are deceased and I only have two much older sisters in the U.S.

I have worked very hard in my career while in Australia, teaching Students with Special Needs, becoming an Assistant Principal and even receiving an Order of Australia medal, for my work with such students. During that time I thought that I had planned my Superannuation to make sure I would be financial in retirement, not asking of the government in a pension, and trying to cover for possible needed nursing home care, my funeral, etc., as not to be a burden as well on my children, and not knowing how long I will live, for my Superannuation to last.

I never expected, and certainly never planned on the U.S. government deciding to take 15% of it away, which over the time of the rest of my life, will add up to a lot of money, that I may need for the items mentioned above. Otherwise, I may have been able to make different plans in some way to cover for this, but to have it happen after you have retired, there is no way now to compensate for this.

I feel this may be legal in the perception of the U.S. government, considering the treaty is to not double tax, citizens residing outside the U.S., and since in Australia, as of 60 years old, our Superannuation is not taxed. The U.S. then thinks they have the right to tax us, even in my case though I have not lived in the U.S. for forty years. I do not feel I owe the U.S. this tax, since I have had no benefits from the U.S. in anyway, in all that time.

I feel this is grossly unjust, unfair and immoral, especially since I have always tried to do the right thing and file a U.S. tax report each year, done by a proper Accountant who deals with U.S. tax, which in itself has cost me quite a lot over the years.

I understand the debt the U.S. is in, but is it so low that it has to hit its U.S. citizen retirees who have for most of their life resided in another country and who are just trying to financially live out their years that are left. I lost my husband to cancer 5 years ago, and through the grieving have suffered physical health problems as well as depression, and anxiety. I did not need the stress and worry of knowing that I was going to lose 15% of my Superannuation as well.

Hoping the U.S. government will review this decision, when understanding the hardship in lots of cases that it is causing,

Dixie Hickman Cole

STATEMENT FOR THE RECORD BY DR. ROGER W. LOGAN, LEGISLATIVE DIRECTOR, COUNCIL OF ENGINEERS AND SCIENTISTS ORGANIZATIONS (CESO)
P.O. Box 118, Renton, WA 98057–0118

Senate Committee on Finance Hearing on "Fairness in Taxation," March 3, 2015

The four panelists at the 3 March 2015 hearing provided some very helpful testimony which is available in PDF form online. All of the graphs in the written testimony materials are noteworthy and worth studying. *What seems to be missing from the testimony, however, is an overall Tax and Budget plan with numbers that are fair, and that work*—that is, a plan that ends the budget deficit, and does so in a revenue neutral way, without cutting defense, and while shoring up the FICA Contract with the Citizens of the U.S.A. We present such a plan here for your consideration.

Revenue Neutral "USA First" Tax and Budget Plan

CESO plan Reduces Income Inequality by Rewarding Personal Responsibility

POSITION: Various world events have led to a disappearing middle class, and along with that a growth in Income Inequality, creating a huge Income Gap between hourly jobs and the upper income class. If there is any "class warfare" going on, the *middle class* is losing rapidly. Both political parties preach about the importance of the middle class, but whether it be gridlock or political compromise, it seems it is always that same middle class that "takes one for the team."

PROPOSAL: Our CESO budget should receive broad appeal, since it offers a Revenue Neutral budget that rewards work and responsibility toward retirement, while achieving Revenue Neutrality and deficit reduction without defense cuts. We propose a solution based on "Team Play" (and we don't mean yet another sacrifice bunt by the middle class). This solution is based on implementation of the CESO Position Papers on Tax Policy,[1] Pensions,[2] and Infrastructure Investment,[3] with supplemental proposed actions on Minimum Wage (MW) and EIC.[4]

HIGHLIGHTS of the CESO Tax and Budget Solution:

- ***Corporate and Personal Income Tax Reform are best addressed as a coupled set***
- ***Static budget balance and debt reduction with revenue neutrality***
  - **Dynamic Economic Growth as a bonus**
  - **Zero Corporate Tax (if profit is re-invested or distributed in USA)**
    - ***Permanent*** **solution to the Repatriation Dilemma**
    - ***Progressive Personal Income Tax in trade for Low/Zero Corporate Tax***
  - **Fair and Balanced treatment of investment income**
    - **Cap Gains and Interest (less CPI) as Earned Income**
    - **Dividends as Earned Income (but Zero Corporate Tax)**
  - **Small (0.1%) Financial Transactions Tax, Personal IRA's exempt**
- ***Reward Work and Responsibility toward retirement:***
  - **Solid future for Social Security and Medicare (FICA Contract)**
  - **Expanded 401K and Roth Limits—"build your own" pension**
  - **Restore EITC for single workers starting (or restarting) their careers**
  - **Ability to invest in FDIC and Treasury insured products within 401K**
  - **True "PBGC" Equivalent for annuities and public pensions**[5]

[1] CESO Position Paper, Tax Policy (Oct. 2013).
[2] CESO Position Paper, Pension Alternatives (Oct. 2013).
[3] CESO Position Paper, Infrastructure (Oct. 2013).
[4] CESO Editorial Supplement on Minimum Wage and EIC (Jan. 2014).
[5] CESO Position Paper, PBGC for Annuities (Jan. 2014).

Following are some details of the CESO Tax/Budget/Pension-Alternatives Plan, presented in 3 major parts [1] Incremental Tax Reform, [2] Pension Alternatives, and [3] A "PBGC" For Annuities.

1. Incremental Tax Reform: Fair and Revenue Neutral

For a dynamic economy with Job growth:

POSITION: "Comprehensive Tax Reform" has come to mean "something that will never happen." Instead, we propose here a package of incremental changes that should appeal to all interested parties, providing economic growth, flexibility for business, enable repatriation without any special "amnesty," and provide economic prosperity for corporations and workers alike with a windfall to shore up deficits in the budget, Social Security, and Medicare.

INGREDIENTS: Enable an effective 0% Corporate Tax Rate, combined with other elements, as follows:

Allow earnings to be retained, tax free, for C- and S-Corporations, if those earnings are re-invested into the USA for infrastructure, hiring people, increasing pay and benefits (up to a max income defined as "rich"), and *only if* the current year's profit (retained earnings) are reinvested as such within one year.

Make Corporate Dividends tax deductible to the Payer

* Tax Dividends as ordinary income (and count them as earned income, e.g. so that the equivalent of self-employment tax (Social Security and Medicare) must be paid, but so that dividend income provides eligibility for Roth IRA contributions).

* To simplify and balance the impact of dividends taxed at regular personal income tax rates, we propose that interest (Savings, CD's, Bonds, etc.) and Capital Gains also be treated as ordinary/earned income in taxable accounts, the same as dividends above (this is already the case for Savings and CD's which is punitive to cautious older savers). However, to make this system fair:

    * Only the amount of gain in excess of the CPI (not the fatally flawed "chained CPI"[6] but the real CPI) would be taxed. This way, savers earning a paltry 2% on their CD's would at least get that gain tax free and hope to keep up with inflation. The average homeowner, selling their home for double after say 25 years, would owe zero capital gains, because they really just paced inflation.
    * Treating (INT–CPI), DIV, and (CG–CPI) as ordinary/earned income is a de facto tax increase on most high incomes. Therefore we suggest implementing the "Romney Super Roth" described in our CESO Position Paper on pensions: Triple the Roth Contribution limit and remove the AGI cap, but also remove all caps on FICA contributions, and extend the FICA 0.9% surtax to all AGI's.
    * 401k (etc), IRA and Roth dividends would be treated as per current law (i.e. taxed as regular income on distribution for 401k and IRA's, and tax free for Roth's).

This solves the repatriation problem permanently. American corporations have nearly two trillion dollars of profit sitting idle overseas. They are reluctant to repatriate those profits and pay as much as a 35% U.S. corporate tax, so the money remains overseas, and remains idle, generating no jobs in this country. There is great concern over the repatriation issue, and many large companies have gone to extreme measures (investing and borrowing even in the face of massive retained earnings overseas) to avoid a repatriation tax. "Repatriation Amnesty" will ultimately fail, ensuring only that we face the same problem again. Our solution is stable, enduring, fair, and good for workers, corporations, and for the U.S. economy.

Details:

Since it is often a poor choice to reinvest everything within a year, we suggest a sliding 5-year (e.g.) scale:

* If all the profit (earned here or repatriated) is invested within 1 year, no tax is due.
* Any profit held for 1–2 tax years is taxable at ⅕ the regular Corporate Tax rate (e.g. 35%/5 = 7%).
* Any profit held for 2–3 tax years is taxable at ⅕ the regular Corporate Tax rate (e.g. 35%/5 = 7%, in addition to the 7% tax from the 1–2 tax year period).

[6] IFPTE, "Retirement Security" Issue Brief: "Oppose the so-called Chained CPI—an inaccurate inflation measure in determining COLA increases for Social Security recipients."

*This continues until tax year 5–6, so any profits held that long will be subject to the entire e.g. 35% C-Corporation Tax rate, or to thee.g. 39.8% S-Corporation Tax Rate.

- The elements above would enable a 0% Corporate Tax Rate, while growing a dynamic economy in the USA and inevitably creating jobs here in the USA.
- In addition, we endorse for the most part the "Investing In America's Economy" budget blueprint[7] of the Economic Policy Institute (EPI), and we feel that our added ingredients round out a more balanced pro-growth proposal.
  - For example, our proposal to enable a 0% effective Corporate Tax rate must be revenue neutral, balanced by some of the revenue sources suggested in the EPI reports. This may well involve a *small* further restoration of the progressive personal income tax rates as they existed before the 1980s, back when the USA was the world's largest creditor and not the world's largest debtor. Support for restoration of progressivity in income taxes has appeared recently in CRS reports and elsewhere.[8,9]
  - As with many leaders in the USA and world,[10] we support a Financial Transactions Tax (FTT), to discourage the parasitic economic drain of High Frequency Trading (HFT). It's a drain—a leak. HFT adds nothing to the economy, it just lines the pockets of day traders. A tax to discourage FTT will make the market fairer to the average investor trying to build their own pension (see CESO Pension Position Paper). Various levels of FTT have been discussed and analyzed.[11] Baker (2010)[12] and Wiberg (2013)[13] note that FTT>0.5% have been shown to adversely affect investing, liquidity and volatility, and discuss an FTT=0.25% or FTT=0.10% as a nominal level. We must remember that with most CD rates <1.0%, even an FTT=0.5% is punitive to investors, not just HFT, so the amount should be just enough to discourage parasitic HFT but not enough to discourage investing. We suggest FTT=0.10% as a starting level to see if this solves the HFT parasitic drain, with levels up to FTT=0.25% considered. For a number of reasons, we recommend against FTT for individual 401k/IRA/Roth accounts.

Details of Implementation of these elements as a package:

- Enable an effective 0% Corporate Tax Rate as follows:
  - Make Dividends tax deductible to the C-Corporation, then tax as regular income.
  - Tax Interest and Capital Gains as regular income, but only after CPI is subtracted.
  - Allow earnings to be retained, tax free, for C- and S-Corporations, *if* those earnings are re-invested into the USA using a [e.g.] 5-year ramp.

- Consider most of EPI's revenue and budget options[7,11] with our added ingredients to round out a more balanced pro-growth proposal.
  - Added progressivity in the personal income tax to offset the enabling of 0% effective Corporate tax rates. (+2% for AGI>$1M and +4% for AGI>$10M)
  - Triple the Roth Contribution Limit. Remove caps on FICA contributions but also on Roth Contributions. Extend the 0.9% FICA surtax to all AGI's for fairness.
  - Implement a *small* (0.10% stocks, rest per EPI) Financial Transactions Tax (FTT) for trading in taxable accounts.

Use the economic windfall from the implementation of this proposal to shore up deficits in the federal budgets, Social Security, and Medicare, so that each American shares the benefit.

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[7] J. Bivens, A. Fieldhouse, E. Pollack, and R. Theiss, "Investing In America's Economy," Nov. 2012, Economic Policy Institute, *www.epi.org.*
[8] *http://online.wsj.com/public/resources/documents/r42729_0917.pdf.*
[9] *http://thinkprogress.org/economy/2012/09/17/857861/study-tax-cuts-rich-no-growth/?mobile=nc.*
[10] Center for Economic and Policy Research, Nov. 2012, *http://www.cepr.net/documents/ftt-support.pdf.*
[11] R. Theiss, "Many Options Exist for Raising Revenue in a Smart and Progressive Manner," Apr. 2013, Economic Policy Institute, *www.epi.org.*
[12] D. Baker, "The Benefits of Financial Transactions Taxes," 17 May 2010, *http://www.cepr.net/documents/testimonies/baker-bundestag-2010-5-17.pdf.*
[13] M. Wiberg, opinion in "Financial Times," 15 Apr. 2013, *http://www.ft.com/cms/s/0/b9b40fee-9236-11e2-851f-00144feabdc0.html#axzz2UXsxIR31.*

2. Pension Alternatives for a Dynamic Economy

Robust, Portable Retirement = Dynamic Economy = Job Growth

POSITION: A major ingredient in the recipe for a dynamic economy is to enable the American worker to be dynamic. This means things like Pensions and Health Care must be robust, continuous, and portable. Other major ingredients include Education and Tax Policy.

INGREDIENTS: We address Health Care, Education, and Tax Policy issues including Repatriation in our other CESO Position Papers. Here, our focus will be in support of a robust, portable "Build your own" pension with a fair risk-return posture.

It is a reality that the traditional defined benefit pension is rapidly disappearing. We can either view this as a "race to the bottom" or as a chance to begin a new era of mobility and freedom. But that "freedom" will only be manifest if there is financial equivalence to the defined benefit pension era. We therefore support the maintenance of the FICA programs (Social Security and Medicare), and that eligibility age be held or even lowered, since FICA comprises most of the "new individual pension" for most working Americans. For those pensions remaining, we would support legislation at the federal and state levels for "anti-spiking" provisions.

Our policies must encourage those 401k/IRA/Roth accounts to *grow*. With disappearing pensions a stark reality,[14, 15] the average American will be more and more dependent on their IRA/Roth accounts. Max contribution limits need to be raised to enable an actual "pension" to be built via an annuity (or self-managed annuity i.e. live off the interest/dividends). $5,000 or even $6,500/yr is not enough. If you work say 40 years and plan to live another 20, you need to put half your working years' annual expense into an IRA each year. If the average worker makes $50K gross, and about $45K after FICA etc, they will need to put about $15K/yr into building their IRA, i.e. live on $30K/yr gross while working and then live on the $15K/yr they have in their IRA, which works if it's only for ½ as many years. We are aware of the fantastic return claims and assumptions that make it appear like only contributing $5K/yr to your IRA is enough, but in fact it is not nearly enough. The Roth IRA limits should be approximately tripled (i.e. $15K limit not $5K limit) to allow workers to build their own portable pension, to replace the corporate pensions that are rapidly disappearing anyway. Catch-up provisions should be retained as-is (i.e. $19,500 limit for those over age 50 but now on wages, (INT–CPI), DIV, and (CG–CPI) income).

Expanding IRA/Roth limits also takes the "Bite" out of taxing dividends/capital gains as ordinary income, as we suggest below and in our CESO Tax Policy Position Paper. Since IRA/Roth earnings grow tax free and IRA gains are already taxed as regular income on distribution, on extra "bite" is taken from the average worker investing to build their own pension. To ensure fairness and balance our suggestions in the CESO Tax Policy Position Paper, we suggest to triple the Roth Contribution limit and remove the AGI cap, but also remove all caps on FICA contributions, and extend the FICA 0.9% surtax to all AGI's.

The higher IRA contribution limits, along with the catch-up provisions, would accomplish much of what former Governor Romney was proposing in his recent presidential bid—that a large portion of investment income be treated as tax free (a "Super Roth") to help the average individual who is trying to do the right thing and save for the future. In our CESO Tax Policy Position Paper, we propose another ingredient that would round out this "build your own retirement" concept: That interest (Savings, CD's, Bonds, etc.) and Capital Gains be taxed as regular income in *taxable* accounts (this is already the case for Savings and CD's which is punitive to cautious older savers). However, to make this system fair, only the amount of gain in excess of the CPI (not the fatally flawed "chained CPI"[16] aka Cat Food Diet but the real CPI) would be taxed. This way, savers earning a paltry 2% (if they're lucky) on their CD's would at least get that gain tax free and hope to keep up with infla-

[14] *http://www.washingtonpost.com/business/economy/low-interest-rates-are-the-final-straw-for-many-company-pensions/2013/05/23/a83bf23a-adbc-11e2-8bf6-e70cb6ae066e_story.html?hpid=z12.*

[15] M. Morrisey and N. Sabadish, "Retirement Inequality Chartbook: How the 401K revolution created a few big winners and many losers," EPI, 2013,
http://www.epi.org/publication/retirement-inequality-chartbook/.

[16] IFPTE, "Retirement Security" Issue Brief: "Oppose the so-called Chained CPI—an inaccurate inflation measure in determining COLA increases for Social Security recipients."

tion. The average homeowner, selling their home for double after say 25 years, would owe zero capital gains, because they really just paced inflation.

Three more important features are needed to make these "build your own" pensions truly secure and *portable, the key to making the economy grow:*

- The first would be to require that 401K and similar accounts provide options to invest in federally insured products such as competitive rate FDIC insured CD's and Treasury products via Treasury Direct and other mechanisms.
- The second would be an extension of PBGC to cover all public pensions,[17] and an analog of PBGC for Annuities. Not just a guarantee of the Principal that you bought the Annuity with, but a guarantee of the Benefit. Otherwise, it is not truly a "build your own" Pension + PBGC situation, but rather a "buy an annuity and hope the company survives"—more like Pensions before PBGC.
- The third would be to protect Social Security and Medicare from benefit cuts and from back-door cuts like the deceptive "Chained-CPI." With stagnant real median incomes,[18] a large set of workers still won't be able to fully "build their own" retirements. As Defined Benefit Pensions disappear, these people are highly dependent on their Social Security and Medicare contracts.

Summary of potential legislation to enhance personal mobility via pension alternatives, in turn enabling a dynamic, growing economy with these elements as a package:

- Expanded 401k/IRA/Roth Limits.
- Interest, Dividends, and Capital Gains taxed as regular income in taxable accounts, but only after subtracting the real CPI (part of a package implementation in our CESO Tax Policy Position Paper).
- Ability to invest in CD and Treasury products within 401K accounts.
- Protect Social Security and Medicare from benefit cuts and from back-door cuts like the deceptive "Chained-CPI." Social Security and Medicare are now the only true Defined Benefit Pension most American workers have left.
- A true "PBGC" equivalent for public pensions and annuities purchased from IRA's etc.

3. A Pension We Can Count On Requires PBCG for Annuities

Robust, Portable Retirement = Dynamic Economy = Job Growth

POSITION: Most workers in the future will "retire" without a pension. Many will instead purchase an annuity with their 401K or other proceeds to create their own pension. While this path can reduce future liability for employers, and increase mobility for employees, it has one fatal flaw: Unlike the traditional pensions insured by PBGC,[19] there is no guarantee whatsoever of a continued monthly income from an annuity if the provider of the annuity fails. We feel strongly that PBGC should offer the option of insuring annuities so that they become the true, insured equivalent of the lifetime income guarantee provided by PBGC for pensions.

BACKGROUND: A major ingredient in the recipe for a dynamic economy is to enable the American worker to be dynamic. This means things like Pensions and Health Care must be robust, continuous, and portable. Other major ingredients include Education and Tax Policy.

We address Health Care, Education, and Tax Policy issues including Repatriation in our other CESO Position Papers. In the CESO Position Paper on "Pension Alternatives for a Dynamic Economy,"[20] we outline a robust, portable "Build your own" pension with a fair risk-return posture. Part of that structure involves the individual purchasing annuities to provide their own lifetime monthly income.

It is a reality that the traditional defined benefit pension is rapidly disappearing. We can either view this as a "race to the bottom" or as a chance to begin a new era of mobility and freedom. But that "freedom" will only be manifest if there is financial equivalence to the defined benefit pension era.

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[17] The recent choice made by Michigan/Detroit to raid pension funds as the "go-to" bankruptcy solution is clear evidence of the need for PBGC for public pensions, the same way that PBGC is needed for corporate pensions.

[18] L. Mishel and H. Shierholz, "A Decade of Flat Wages," EPI, 2013, *http://www.epi.org/publication/a-decade-of-flat-wages-the-key-barrier-to-shared-prosperity-and-a-rising-middle-class/.*

[19] Pension Benefit Guarantee Corporation, *http://pbgc.gov/wr/benefits/lump-sum-or-annuity.html.*

[20] CESO Pension Position Paper, Sept. 2013.

Ever since 1974, the PBGC has guaranteed continuation of a *lifetime monthly pension income* in case of financial failure of the employer pension plan.[21] However, the traditional pension that was the mainstay of America's manufacturing greatness is becoming increasingly scarce. The new normal encourages the individual to save, via IRA or 401K or other means, and purchase their own annuity to build their own lifetime monthly pension. The missing ingredient in this new recipe is the guarantee. Individual Americans holding an annuity are entirely at risk of the health of the financial institution providing the annuity. Many such institutions would have failed during the depression of 2008 if not for the massive taxpayer bailout provided to them. Since that bailout almost did not happen, it is clear that the long term future of the lifetime monthly income from a purchased annuity is at risk. This would cause a major disruption in the economy exactly at the same time as we face the next 2008-style depression. The result might well be more akin to a 1930s Great Depression.

The easy and compelling fix is to create a branch of PGBC that *guarantees the lifetime monthly income* from individually purchased annuities. The annuity would then become the true, modern, perhaps even equivalent pension alternative—providing less long term burden to the employer, and more mobility to the worker during their career.

Currently, annuities come with no such guarantee. Even the typical State Guarantee Corporation (SGC), should they survive a depression style run of financial failures, does not provide such a guarantee. The State programs are not backed by the Treasury, so their guarantee is limited to what an individual already stressed state budget can provide. But it's worse than that. The State "guarantee" does not guarantee the pensioner their monthly income for life. In fact, the State does not even guarantee return of the pensioner's initial investment. Rather, the State in general only guarantees the Contract Value of the annuity. After only a couple of decades, this Contract Value stands a good chance of being exactly zero, due to provider fees or poor market performance, at the very time the guarantee would be needed. The most accurate short summary is to say that these *Annuities effectively have no guarantee at all,* in contrast to what is often discussed in urban legend.

The GRA (Guaranteed Retirement Account)[22] plan has some of the elements of the traditional but disappearing pension plan; employer and employee contributions, with a "pension" (i.e. purchased Annuity) for lifetime monthly income. The GRA concept is an integral part of the CESO position on retirement and pensions, but an essential missing ingredient is the "PBGC" style guarantee for Annuities as we just discussed.

Summary: A PBGC Guarantee for Annuities

- Annuities today carry an assumed guarantee but in reality they have no guarantee.
- A PBGC-style Annuity would guarantee lifetime monthly income like a pension.
  - This is what the "new normal" retiree thinks they are buying.
- No need for taxpayer investment.
  - Handle premiums like the current PBGC.
  - Ability to invest in CD and Treasury products within 401K accounts.
- Result:
  - Employers are relieved of pension future liabilities.
  - Employees gain a guaranteed pension with mobility.
  - Everybody wins.

[21] In the recent (Dec. 2014) CR-Omnibus bill, the integrity of the multi-employer portion of PBGC has come under attack. This is a dangerous new development and must be addressed separately. See *http://time.com/money/3630348/congress-pension-cuts-retirees/* and *http://www.stltoday.com/news/opinion/editorial-middle-class-retirees-deserve-better-from-congress/article_70a477f3-15af-5773-8aa5-352875630df9.html* and *http://teamsters174.net/representatives-comment-on-pension-cuts-in-omnibus-spending-bill-2014/* and *http://www.washingtonpost.com/business/economy/congressional-leaders-hammer-out-deal-to-allow-pension-plans-to-cut-retiree-benefits/20l4/12/09/4650d420-7ef6-11e4-9f38-95a187e4c1f7_story.html?hpid=z6* and *http://www.washingtonpost.com/business/economy/congressionaI-leaders-hammer-out-deal-to-allow-pension-plans-to-cut-retiree-benefits/2014/12/09/4650d420-7ef6-11e4-9f38-95a187e4c1f7_story.html?hpid=z6.*

[22] Teresa Ghilarducci discusses the GRA as a proposal during a Retirement-USA conference, *http://www.retirement-usa.org/proposals-new-retirement-system* as noted by the Pension Rights Center, *http://www.pensionrights.org/what-we-do.*

Nomenclature:
CD = Certificate of Deposit
CG = Capital Gains (tax issues)
CPI = Consumer Price Index
DIV = Dividends (tax issues)
EIC = Earned Income Credit. Used to benefit single entrants to job market but now does not.
EPI = Economic Policy Institute
FDIC = Federal Deposit Insurance Corporation
FICA = Federal Insurance Contributions Act
FTT= Financial Transactions Tax
GRA = Guaranteed Retirement Account
HFT = High Frequency Trading
INT = Interest (tax issues)
IRA = Individual Retirement Account
MW = Minimum Wage, currently $7.25/hr. Average from 1950–2013 is $7.65/hr
PBGC = Pension Benefit Guaranty Corporation
QE = Quantitative Easing
SGC = State Guarantee Corporation
UI= Unemployment Insurance

LETTER SUBMITTED FOR THE RECORD BY MARTHA A. HENDERSON

30 Terrigal Place, Engadine NSW 2233, Australia
ahe80933@bigpond.net.au

The Honorable Senator Hatch, Chairman
The Honorable Senator Wyden, Ranking Member
Senate Committee on Finance
Attn. Editorial and Document Section
Rm. SD–219
Dirksen Senate Office Bldg.
Washington, DC 20510–6200

MARCH 3, 2015

"Fairness in Taxation"

Dear Senator Hatch and Senator Wyden,

I appreciate the opportunity to submit a written statement for the record of the Senate Finance Committee Hearing on March 3, 2015 on fairness in taxation.

The U.S. Congress is taking an important and much needed step in addressing tax reform, including how it relates to non-residents, as a top priority of the 114th Congress.

Since much of current tax legislation was enacted the international economic environment has changed considerably. The economy is now global in nature with businesses functioning across international borders and record numbers of Americans taking up employment and residence in foreign countries—often indefinitely—as part of the global workforce. Tax law must facilitate the global economy by providing fairness for individual tax payers, including non-resident citizens.

I have read with interest a number of recent publications and position papers advancing the concept of moving from citizen-based to residency-based taxation, including Comprehensive Tax Reform for 2015 and Beyond published in December 2014 by the Republican members of the Senate Finance Committee. With this approach U.S. citizens residing and working overseas would be taxed by the U.S. only on income from U.S. sources. This sensible approach would:

- provide fairness by eliminating double taxation
- provide mobility for individuals functioning the global economic environment
- reduce the impact of currency fluctuations
- reduce the level of financial hardship, administrative work and anxiety currently being experienced by non-resident U.S. citizens

I write from the perspective of an American citizen living abroad who:

- has resided and worked in Australia since 1973, shortly after marrying an Australian citizen
- became a dual citizen of the U.S. and Australia in 1995
- has met my legal obligations by submitting annual income tax returns to both the Internal Revenue Service and the Australian Tax Office

- despite having taken a long-term and disciplined approach to managing my finances has been hampered by current tax law and international tax treaty arrangements in my efforts to maintain my current modest life-style and financial independence upon retirement
- has annually faced uncertainty with regard to the amount of tax that I will have to pay due to fluctuations in the exchange rate
- does not qualify for social security benefits

My comments as outlined below will be limited to a number of aspects of the current citizen-based U.S. tax framework that have adversely affected me and that demonstrate the need for a move to residency-based taxation. In particular I will comment on:

- unfair taxation of my retirement savings leading to financial stress
- the impact of fluctuations in the exchange rate in relation to non-resident individuals
- the impact of the implementation of *United States' Foreign Account Tax Compliance Act* (FATCA) on non-resident individuals.

Unfair taxation of retirement savings leading to financial stress

The legislative framework of the United States, including tax treaty arrangements between Australia and the United States, requires U.S. citizens who are in the Australian workforce and have Australian superannuation (retirement) funds, to report and pay U.S. tax on these funds. It is not recognized that Australian superannuation funds meet Australian regulatory requirements and are similar in purpose and structure to American retirement funds which are not similarly taxed. Nor is it taken into account that the taxation of Australian superannuation funds by the U.S. amounts to double taxation; Australian superannuation funds are already taxed, albeit at different intervals and different time frames than retirement funds in the U.S. This is unfair and immoral.

U.S. citizens holding Australian superannuation funds that comply with Australian legislation are subject to U.S. income tax as on the following:

- personal and employer contributions
- annual income of the fund
- capital gains on investments sold within the fund for that tax year, even if they are actually capital losses but become capital gains due to the exchange rate
- rollover into another fund or an annuity/pension arrangement, even when the fund offers no alternatives to rollover
- account based pensions set up within the Australian superannuation framework.

As non-resident U.S. citizens approach retirement and the value of their superannuation funds increase their total assessable annual income as defined by U.S. law can increase significantly placing them in a 39.6% U.S. income tax bracket. Due to the fact that under Australian law they cannot withdraw money from their funds to pay the tax because they have not reached "preservation age," they can find themselves facing severe financial stress.

Over the majority of the 43 years of my working life I maintained a modest lifestyle as an educational professional in the largest state-based Australian public vocational education system, TAFE NSW. I was principally involved in teaching and curriculum development in the creative arts and business-related disciplines. I was the breadwinner in the household from the mid-1990s until I was made redundant in 2014.

Throughout my working life I saved towards a retirement that would enable me to continue my modest lifestyle independent of governmental financial support. However, due to taxation of my retirement savings under U.S. tax law this may not be possible. Furthermore, as my retirement savings run down and I require government assistance the Australian Government will have to provide it; I did not work in the U.S. for the required 40 quarters prior to relocating to Australia and am therefore not eligible for a Social Security pension. In fact I am entitled to few if any benefits from the U.S. despite paying hundreds of thousands of dollars in U.S. income tax.

I provide the following personal information to demonstrate the negative impact of U.S. tax on retirement savings of non-resident U.S. citizens living in Australia. It is important to understand that in addition to Australian superannuation funds incurring U.S. income tax individuals' funds are taxed under Australian tax law.

Under the Australian legal framework individuals are not able to claim tax credits for U.S. tax paid.

- For my 2013 U.S. return I incurred a tax bill of approximately U.S. $18,600 (close to AUD $20,000 taking into account the exchange) on the income of my superannuation funds. This represented close to 40% tax on the earnings of my funds at the time they were earned. This money had to come from earnings outside of my retirement savings and represented a significant percentage of my in-hand income.
- The situation will be worse for 2014. I am expecting a tax bill of between U.S. $20,000 and $25,000 on the income of my superannuation funds (AUD $26,300 to $32,500).
- Because the U.S. treats superannuation funds as trusts rather than compliant retirement funds, rollover into a pension stream is treated as a tax event. Under the rules of my employer funded superannuation plan I am required to rollover, so I will lose a significant amount of the value of my retirement savings. If the value of the dollar is $0.77 when my tax is assessed and is still $0.77 I have been advised that will be subject to a tax bill in the vicinity of U.S. $162,000 (AUD $210,000). This represents a significant amount of my retirement savings.

I am being treated as a tax evader rather than as an individual who has worked hard to support a family and to save towards becoming and independent retiree. Many other nonresident U.S. citizens will find themselves in a similar situation.

While this issue could potentially be addressed through amendment to the *Double Taxation Taxes on Income Convention between the United States of America and Australia,* I believe such an approach would be inefficient and expensive when applied to a problem that is common to non-residents in many countries. Additionally, I understand that passage of international tax treaties through Congress has been blocked since 2011 by one Senator, so time and money invested in treaty negotiations would undoubtedly be wasted and non-resident citizens would continue to be unfairly taxed.

The most appropriate way to address the issue of foreign retirement plans held by nonresidents would be through a residency-based taxation system.

Impact of currency fluctuations

Fluctuations in the exchange rate can significantly impact on non-resident individuals trying to responsibly manage their finances, including saving towards retirement.

While under current U.S. tax law non-resident individuals are required to compute and pay U.S. income tax in U.S. dollars, I understand that U.S. owned companies operating overseas operate in the local currency. This is inconsistent and unfair to ordinary individuals residing and working overseas.

The impact of the exchange rate on taxation of my Australian superannuation fund is evident from the information provided above. While I recognize that the exchange rate can just as easily move in the opposite direction, fluctuation in the exchange rate from the point of earning income to calculating the amount of U.S. tax due and then finally having to pay the tax is a source of much anxiety; I never know whether I will have enough accessible money to pay the U.S. tax imposed on my earnings.

Currency fluctuation can also have significant impact in relation to capital gains and losses. If an investment is sold and makes a capital loss the exchange rate can transform the loss into a capital gain, making it subject to U.S. income tax. In the same way a capital gain in Australian currency can translate to a capital loss in U.S. dollars. This is illogical.

The currency of the country of residence should be the functional currency for individuals and should be integral to a non-residency based tax system.

Impact of the implementation of FATCA on non-resident individuals

The implementation of FATCA has seriously impacted on ordinary non-resident citizens, including those residing in Australia.

While I understand the logic behind and support the move to limit tax evasion through FATCA, I believe its implementation through The Agreement between the Government of Australia and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA has resulted in in-

consistencies of application and a major reporting impost on ordinary U.S. citizens residing in Australia.

Under the terms of the agreement Australian superannuation funds that are deemed compliant are excluded from the definition of Financial Accounts and therefore are not treated as U.S. Reportable Accounts. This indicates that the IRS considers these funds to be low risk in terms of tax evasion. However individuals are not covered by this agreement, and American citizens holding Australian superannuation funds must report on their funds as outlined above.

The principle of excluding superannuation funds that are deemed compliant from the definition of Financial Accounts should also be applied to U.S. citizens residing in Australia. When their Australian superannuation funds are designed specifically for the purpose of providing retirement benefits and meet Australian regulatory requirements they should be exempt from reporting to and taxation by the U.S. Government.

The requirement to report financial assets twice, once for the FATCA requirement and again for the FBAR requirement, is illogical and burdensome. Reporting requirements are complex and require submission of a tremendous amount of paperwork, particularly in relation to Australian superannuation accounts. Due to the onerous reporting requirements and extremely limited availability of assistance from IRS I no longer feel confident to complete my own tax returns. I require the assistance of a tax expert who is conversant with both U.S. and Australian tax law. It is difficult to find someone with this expertise and their services are understandably very expensive. It took me over six months to find a tax attorney who was prepared to help me rectify an error I made in my 2012 tax return. My 2013 U.S. income tax return required submissions to two different locations in the U.S. one of 116 pages and the other 81 pages. Preparation of my 2013 return cost in excess of AUD $2,300.00, and expenses for printing, postage and conversion of Australian funds to U.S. dollars for tax payment amounted to a further AUD $200.

Also of great concern are numerous reports of the financial hardship psychological stress individuals suffer when they suddenly and unexpectedly discover they have been denied access to the financial institutions and companies with whom they have been doing business because these institutions do not want to deal with the administrative work associated with FATCA. I cannot imagine how stressful this must be and I worry that it could also happen to me.

A residency-based taxation system would address many of the FATCA related issues currently impacting on non-resident citizens.

Conclusion

Current U.S. tax law is not working for non-resident U.S. citizens: it is unfair with respect to its treatment of retirement savings and functional currency requirements, is administratively and financially burdensome and it is making it very difficult for non-resident individuals to tunct1on effectively in the global economy.

The U.S. tax system needs to facilitate the participation of its citizens in the global economy and encourage and assist responsible financial management by non-resident individuals, particularly with respect to their savings and investments.

It is recommended that residency-based taxation, including provisions for functioning in the currency of country of residence, be legislated to

- provide fairness by eliminating double taxation
- provide mobility for individuals functioning the global economic environment
- reduce the impact of currency fluctuations
- reduce the level of financial hardship, administrative work and anxiety currently being experienced by non-resident U.S. citizens.

Sincerely,

Martha A. Henderson

LETTER SUBMITTED FOR THE RECORD BY K. MARGARET SCHEIDLER

33 Granger Ave.
Lismore NSW 2480
Australia

Senate Committee on Finance
Attn. Editorial and Document Section
Rm. SD–219
Dirksen Senate Office Bldg.
Washington, DC 20510–6200
USA

February 28, 2015

U.S. Senate Finance Committee

Re: Fairness in Taxation, scheduled for March 3, 2015

I am a U.S. citizen currently residing in Australia and am wondering if the following issues could be addressed in the above meeting please:

- If a person has superannuation in Australia, it may not be taxed here depending on the age of that person, but it has to be reported to the IRS as income, so that it is taxed in the U.S. This amount may grossly adversely affect a person's retirement income and has nothing to do with earnings gained in the U.S.
- Simplification of tax returns with the implementation of FBAR and FATCA. The financial and administrative impact should be considered.
- With fluctuating exchange rates, it may mean a really hefty tax bill depending on the current rate. For a responsible person trying to manage their finances, it makes things very uncertain.
- There is a decided lack of benefits for expats.

It seems that the whole system would be simplified if the person only pays tax to the country on the income derived in that country and if the income is derived from overseas, then it shouldn't be taxed.

Many thanks for your consideration.

Sincerely,

K. Margaret Scheidler

LETTER SUBMITTED FOR THE RECORD BY GERALD E. SCORSE

Re: "Fairness in Taxation," Senate hearing, March 3, 2015

My name is Gerald E. Scorse. I live at 392 Central Park West, New York, NY 10025. I make this statement for the record as a citizen and a taxpayer. I represent no organization.

Roth individual retirement accounts (IRAs) are inherently unfair. All other retirement accounts—for example, regular IRAs, 401(k)s and 403(b)s—ultimately pay taxes both on contributions and on withdrawals. By contrast. Roth accounts pay taxes only on contributions. All other retirement accounts require distributions. By contrast, Roth accounts do not.

These inequities increase the tax burden on all non-Roth account holders; in addition, they're a continuing drain on the U.S. Treasury. I explored these inequities, and the fiscal consequences of the inequities, in an article headlined "Roth IRAs Painting the Treasury Red." The article follows, and constitutes the balance of my statement. I thank the Finance Committee for the opportunity to make the statement. It's a great country where an ordinary citizen has a chance to be heard by the legislators who represent that country in Washington, D.C.

Here is the text of the article, which appeared in numerous online publications. (Copies were also emailed at the time to all members of the Senate Finance Committee.)

Imagine the government pushing a retirement plan that's guaranteed to raise the federal deficit. Imagine that the same plan inherently favors the already-favored.

Far from imagining. You're describing Congress's growing embrace of Roth individual retirement accounts (IRAs).

The lure of Roths is the up-front revenue they bring in. Contributions to Roths are after-tax, unlike the pre-tax contributions to regular IRAs, 401(k)s, and other traditional plans. In fact Roth accounts are costing the Treasury billions upon billions. Let's see what drives the losses, and why they'll be climbing far into the future.

All the money in retirement accounts gets preferential tax treatment going forward. Capital gains grow untaxed, lifting balances year after year. Traditional accounts pay the country back through taxable withdrawals—voluntary starting at age 59½, mandatory at age 70½. The inflows to the Treasury square the books on a win-win bargain: decades of tax-free growth for retirement savings, coupled with decades of growth in downstream tax revenues.

There are no downstream revenues from Roths. Capital gains are permanently tax-free, creating Treasury shortfalls that erase and ultimately far outstrip the initial boost. There are no required distributions (which might at least spin off some revenue). Losses from Roths grow endlessly; the only question is how large the final numbers will be. Such are the accounts that Congress has chosen to promote-most directly to the affluent, whose incomes once barred them from owning Roths.

The red ink has effectively been flowing ever since the accounts were created in 1997. It turned a deeper red when Congress did away with the $100,000 adjusted gross income limit for Roth conversions. These are paperwork transactions that turn regular IRAs into Roth IRAs. To do this, account holders first have to pay the taxes on the converted amount. The tax bill discourages conversions—but for the well-off, not so much. Investment giants Fidelity and Vanguard reported conversion bonanzas when the income limit came off in 2010.

Roth conversions were back again as part of the 2012 "fiscal cliff" budget deal. The agreement opened the door to immediate conversions by 401(k)s and the like; until then, holders couldn't convert to Roths before age 59½.

Earlier this year, the Republican majority on the House Ways and Means Committee unveiled the most sweeping tax reform plan in a generation. It makes the first direct attack on traditional accounts, and would sharply increase Roth ownership. It would prohibit any further contributions to regular IRAs. It would limit annual contributions to other traditional accounts to $8,750 half the current maximum; contributions over $8,750 would be channeled into Roth accounts. The income limit for start-up Roths would disappear, just as it has for conversions. According to the GOP plan, these changes would raise about $160 billion over the period 2014–2023. The number is just the latest Roth hocus-pocus: the losses would eventually swamp the apparent gain.

It's good to help workers save for retirement, as traditional accounts have been doing since the mid-1970s. In contrast, Roths are no help for those who need it but a windfall for those who don't. They cost the Treasury untold billions. They're also plainly unfair: why should Roths pay taxes only on contributions, while all the other accounts pay on gains as well? Why should the others require distributions, but not Roths?

Howard Gleckman edits TaxVox, the blog of the nonpartisan Tax Policy Center. In 2010, with Roth conversions booming and talk of more Roths already in the Capitol air, he flashed a warning signal: "This infatuation with all things Roth bears close watching."

The infatuation keeps growing, and the red ink just keeps rising.

LETTER SUBMITTED FOR THE RECORD BY DON ZWIERS

Senate Committee on Finance
Attn. Editorial and Document Section
Rm. SD–219
Dirksen Senate Office Bldg.
Washington, DC 20510–6200

Fairness in Taxation February 26, 2015

United States Senate Committee on Finance
Tuesday, March 3, 2015, 9:00 a.m.
215 Dirksen Senate Office Building
Fairness in Taxation

My name is Don Zwiers, retired engineer, WPI BSME 55. I represent all of America, single handily; nobody wants to talk about it. Either I am way out in front or I just don't get it. I think our leaders can't see the trees for the forest.

I have a simple proposal that our President has to ask Congress and only he can do it. None of us can because there are too many of us to agree. He has to ask them; *Why can't we have as the only revenue governments can have, is an Adjustable Consumption Sales Tax on all products and services, created for profit?* Eliminates all Special District Governments and only allow the Federal Government, state, county and local governments to collect the tax. **IF WE CAN; DRAW UP THE LEGISLATION AND PUT IT INTO LAW.** ***(United States Constitution, ARTICLE I, Section. 8—Congress shall have the power to lay and collect taxes and to pay debts for the common defense and general welfare of the United States and shall be uniform throughout the United States) and the 16th Amendment, (tax spending instead of earning; since everyone spends money as long as they live but not everyone earns an income throughout their life.)***

It probably doesn't have to be any longer than this because there are no exceptions and everyone pays the same tax as the next person in line. Governments become smaller and the Free Market becomes stronger.

The Federal Government has one Health Care System and they will pay only licensed doctors' invoice as submitted within 30 days and they all compete with doctors for patients. Everyone pays the same adjustable sales tax when they spend their money and the budget is always balanced because the tax is adjustable to stay balanced. If something is too expensive; can't do it, it's not ready yet. With all this data in one place; patient Medical History can be isolated to its own record and made available to patient, doctor and research costs included.

Insurance companies will handle all accident insurances because they know how to place people in risk pools and charge them accordingly to make a profit while they compete with other insurance companies.

They also fund only one retirement program that everyone belongs and is also funded by its own Adjustable Sales Tax; today's dollar pays for today's retiree and depends on how many people are over 55 years old. That retirement income must be the amount a person needs to survive without additional government help, where they live. Local governments have to determine what that is.

They also use another Adjustable Sales Tax that will fund a program that every person will have a job or the local government will hire them at 95% their minimum wage. Since unemployment is a National Problem; it's OUR problem. Therefore the Fed will fund 40% to the local government and the states, 30% and the county 20% leaving the balance to be paid by the local government. The adjustable sales tax specifically for this makes it sustainable forever. That person will either find a job soon or move where there is work. This eliminates all of our entitlements because they aren't needed.

We have 4 governments and we need them all working together; like any man made machine. Each has its function and needs to be well oiled with money from its own tax payers; but without remorse. Everyone has to feel his/her contributions are shared equally; not some people getting more just because they have extra money.

The Federal Government has to be in charge; we only have one President. Small states need as many votes as a big one; we don't like bullies. We also have more

people in some states and their needs are different. There aren't as many farmers, but they still need their voices heard; we need their food.

Local and county governments also represent everyone; therefore, along with the Federal Government, they also affect us all. States are different and have to be responsible for their land and natural resources, which we all share together. We have sea shores and mountains, deserts and forests, hot and cold climates, farming and mining industries; all of which are important to everyone; we depend on what they offer. These governments have to work as a machine; if not, they break down.

This is where we are today; broken and we need fixing. We can't just keep giving these problems to our grandchildren. Stop donating your money to someone else to solve them; be part of the solution, it's our Children and our taxes that are needed today.

Who says somebody can own land all the way to the center of the earth. People are here for one lifetime; they each have the same opportunity to use the land and natural resources but they are also responsible for POSTERITY; our grandchildren we will never meet, may need something we wasted years ago and its all gone. This can't happen. Give people a free permit to use the land for a specific purpose and must abide by the regulations the government establishes to insure it will be available for future generations. The same with our resources; we must recycle what we mine or create and make sure there will always be enough for POSTERITY. Water, air, oil, rain forest and glaciers all have their place; World Wide. This means we need to work with the UN to include us all.

Inflation/deflation: is it good or bad?

Employers must always be aware of the cost of doing business. The triple bottom line concept, being discussed today, puts profit in competition with ecological and social performances. Our government, the largest single employer in America must also be aware of the triple bottom line.

Without having to keep tax records or putting up with Union demands, health care, pensions and work rules, companies will have more money to run their business. If they are working in the Free Market System, they will be competing with each other for profits. They also want to feel comfortable that other companies are playing under the same rules. Therefore, if they are saving all this money too, what they do with their savings, also become competitive. Sharing this savings with their employees doesn't make sense because they aren't doing anything different and investors are interested in PROFITS so they would rather see higher profits. Repair and upgrade equipment would decrease costs later on and could be a good use.

Let's assume everyone just reduces the price of their products or services and maintains everything else, including their profit margin. I'm sure their customers would want to buy more, increasing the demand, increasing production, hiring more workers and generating more profits for all investors. Then since their suppliers are also doing the same, reducing their prices: even more price reductions are possible.

AMERICA caused a very interesting phenomenon; CONTROLLED DEFLATION. Yes, the prices of all goods go down and jobs are created without the government, businesses or banks using their money. The purchasing power of everyone spending money is increased. This is their raise. Free Market and the laws of supply and demand take hold and America starts growing at an uncontrollable rate. American manufacturers will build new modern factories here and stop importing their own products back to America. They will leave their factories where they are and sell those products where they are. Maybe those countries will follow what we are doing; taking care of their people and let the people with the most money pay the largest portion of their country's cost, taking care of their people.

Inflation could be the thing of the past. It really doesn't make sense anyway. What's this thing called "COST OF LIVING INDEX"? WILL THIS ALSO BE ELIMINATED? *Does this sound feasible? What do you think?* Our nation must agree with this concept before we can all be winners.

How about this $18 trillion debt? How about spending that money while we payoff the debt? We can even tax this additional money during the time we have it; saving taxpayers more money.

What do you think?

I spend money I don't have; like buy a house, I go to the bank and borrow what I need, plus the interest and pay it back in small payments over a designated period. In the end, I own it and debt free. However if I borrow a small

amount from my dad and give him an IOU; then when I pay him back, he tears up the IOU. I have what I bought and I own it.

Why can't a government do the same thing with their burdensome debt? Just paying the interest is hard enough. Isn't the Federal Reserve, also the government's bank; I think so. Couldn't we assume the Feds are like the government's dad? We are all in the same family.

Therefore; if they would just pay all our government's debt and allow the taxpayers to pay the Federal Reserve back in equal monthly payments over 30 years; our children wouldn't have to pay it. Those IOUs the governments gave to the people's trust fund to pay their bills are now wiped out; we don't have to pay ourselves, we can't spend it twice.

The Federal Reserve is everyone's bank and they are there to control our money supply; and doesn't need to make a profit like a regular bank; so they don't charge interest, we're all family; just make sure they receive the payment each month, A special adjustable sales tax to be used for 30 years only. Take that payment and send it back to the U.S. Treasury to take it out of circulation it was already spent.

In the meantime they allow the rest of money to remain in the economy until it is paid back (30 years). The economy has all this money to spend; however people decide to spend it. The additional sales tax collected in all four governments even saves the taxpayers more money; allowing each citizen to keep just a little more of their money to spend someplace in the economy and pay the required tax; Everyone seems to be the winners; the wealthy just spend more, save more and pay more taxes.

Yes, this money is circulating in the Free Market worldwide; with no restrictions, other than what money has now. Looks like a Win-Win.

There are many more benefits to the Adjustable Sales Tax concept not mentioned here but nobody knows at this time WHY NOT? This has to be our Congress to determine the answer; they make the laws.

Thanks for hearing what I have to say. I will be watching Tuesday.

Don Zwiers, Joliet, IL. Cell 815–685–8054 *uhcplan09@sbcgobal.net*

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